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Vol. III

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1942

No. 319

FIDELITY ASSURANCE ASSOCIATION, A CORPORATION, DEBTOR, AND CENTRAL TRUST COMPANY, TRUSTEE FOR FIDELITY ASSURANCE ASSOCIATION, PETITIONERS,

vs.

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, AND EX-OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 20, 1942.

CERTIORARI GRANTED OCTOBER 12, 1942.

SUPREME COURT OF THE UNITED STATES

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Cross-examination.

By Mr. Huwe:

Q. Mr. Smith, when Mr. Godfrey came to see you was it for the purpose of getting the securities out of Wheeling? Was that his purpose?

A. His first trip was designed to take possession of those securities, which we explained to him were under the jurisdiction of the state court, and then in turn we suggested that he go back and discuss it with the state officials and bring receivership proceedings to protect the contract holders.

[fol. 2377] Mr. Huwe: Your Honor, I am sorry I wasn't here at the beginning of the resumption. I would like to make just a short statement in reference to an answer to Mr. Dunifon's statement.

The Court: All right. I will permit you to do that. Go ahead.

Mr. Huwe: Mr. Rivers informed me that he had examined the law of Ohio and discovered that a contract holder should file a mandamus suit to compel the State Treasurer, combined with the Insurance Commissioner, to liquidate the deposit if the company was insolvent. The receivership proceedings in Kanawha Circuit Court in West Virginia had declared the company insolvent. Mr. Rivers learned of the receivership suit from the Insurance Commissioner or the Attorney General's office, and rather than duplicate law suits by filing a separate mandamus suit he thought he was doing a good turn by filing a cross petition in the injunction suit. However, he prepared the foundation for both a mandamus suit, which Mr. Dunifon has admitted is authorized by a creditor in the State of Ohio, and he used the same letter for an injunction suit, or rather cross [fol. 2378] petition in the injunction suit. I went along with him when he filed the cross petition in Columbus, although it was his case, and we were unaware on June 10th or 11th that the Federal Court had taken jurisdiction on June 6th. So was the Court unaware. We had not notified the Attorney General's office, although we were including the Treasurer in the cross petition, because of the rules of practice familiar to our own district and county, which were different with respect to notifying a prospective defendant

in an intervening cross petition. So we didn't give the other side notice. We filed the intervening cross petition and got our service on Mr. Smith and other people out of the state according to statute; and then we received a letter—I think Mr. Rivers received a letter—not from the Court, but from the Attorney General—although I am not sure about that first letter—stating that there had been some Federal proceedings enjoining any state procedure. By the time we got up to Columbus on the matter the second order of June 10th explicitly clarified any doubt which we had originally raised with reference to whether it covered property of the debtor in the State of Ohio, because it [fol. 2379] named the deposits and named the various offices; so on the strength of that, and in addition to the fact that we had not given the Treasurer notice under the rules of the Franklin County Courts of Ohio, the Court said he was going to put on an order dismissing our cross petition. Mr. Rivers had laid the foundation, however, for a mandamus suit, which would have liquidated the deposit, a purely ministerial act on the part of the Insurance Commissioner; he had to follow the law once insolvency was established. So that, had the federal case not intervened, that suit would still probably be in progress and would have forced Mr. Lloyd to liquidate rather than co-operate with the West Virginia state receiver.

When this matter developed Mr. Rivers and I came in to try to find out the picture, and we intervened, still thinking that liquidation was proper, because we had been informed by a broadside from Columbus—whether it was the Attorney General or the Insurance Commissioner's office I don't recall—that Series D was insolvent in a small degree, as well as all series of contracts. When we got into the [fols. 2380-2381] hearing on August 4th and 5th^a and examined the exhibits of the trustee filed on August 5th, we discovered Series D solvent, Series B and Series C solvent, and Series A solvent under certain conditions. Of course, that was the factor which caused us to change our course of conduct with reference to wanting the company to be liquidated. Series B, especially, having over 50 per cent of all the contracts and all the assets and all the liabilities of the company, being solvent, it was our opinion that since the major per centage of contracts, liabilities and assets were in funds that were not insolvent, that there was a chance for the company to be reorganized; and we have

therefore followed that position ever since. That brings us up to date. If I am mistaken in any detail I will be glad to have Mr. Donifon correct my statement.

[fol. 2382] Q. What were your relations with any other state, whether receiver or state official with whom you had contact?

A. Mr. Lloyd, from Ohio, came over, and he had already been appointed receiver for the assets other than the deposit, and we told him we hoped that nothing would happen over there that might disrupt our plan to reorganize the company—What other states? There were three states.

The Court: Pennsylvania.

A. Oh, Pennsylvania. The receivers for the Western District of Pennsylvania came down. Of course, they had no assets, as the deposit in Pennsylvania had been were not much concerned with those fellows.

Mr. Reinhardt: You testified that you were the choice of Mr. Sims as receiver. Who chose Mr. Thomas?

A. I don't know.

Mr. Palmer: I believe Mr. Sims testified about that. If Mr. Sims knows any more about it I will be glad to have it. [fols. 2383-2386] Mr. Sims testified that he personally picked Mr. Isaiah Smith, but after a conference with Mr. Arthur Koontz, who believed that on behalf of the company there should be two, one of them a legal representative, and it being represented to Mr. Sims that Mr. Ross Thomas was very familiar with the legal structure of it, he appointed him as well, and that he had later found out that the representations as to the legal knowledge of Mr. Thomas concerning it had been well taken.

The Court: That is about what Mr. Sims said:

[fol. 2387] Q. Mr. Smith, I understand that in your opinion the proper basis for any plan of reorganization would have included all of the contract holders and all of the assets in all of the states.

A. Most certainly. I would think any plan we would work out we would have to take into account all of the [fol. 2388] assets and all the liabilities before starting to

work on working out any constructive plan of reorganization.

Q. And your position as state court receiver was such that after you worked out such a plan, if any state refused to co-operate with the plan you had no way to compel it to.

A. As a layman I would say that was my notion of the law, that we had no jurisdiction beyond the bonds of West Virginia.

Q. And assuming that you had no way to compel one of the states other than West Virginia to co-operate with the plan, and some other state did not co-operate, what would that failure to co-operate do to the plan?

Mr. Palmer: If your Honor please, I think I understand what Mr. Ray is asking, and when he speaks of states refusing and so forth, there is a distinction between contract holders within the state who might or might not voluntarily go along with the plan and state statutory officials who might refuse to co-operate officially with any plan but would permit their contract holders to, and I believe that Mr. Ray could be helpful in making his question a little more clear [fol. 2389] in reference to just what he has in mind in that regard.

Mr. Ray: What I meant by the states is those persons, either state officials or officials appointed by courts, who had charge of the deposits of the company in those states.

The Witness: That is right. Now let me have the question.

(The question was read.)

A. Of course, it would depend on the size of the deposit in the states and the liabilities that might be in the state that refused to co-operate. Take a state with large deposits, such as Wisconsin or Illinois, that would affect materially, of course, and would tear your plan completely down and you would have to build another plan excluding from it the assets in that particular state.

Q. Will you be a bit more specific and tear it down?

A. Well, let's assume that the assets of the company—I am using figures just for the purpose of illustration—supposing the assets of the company were valued at \$23,000,000 and that the liabilities of the company were \$25,000,000. [fols. 2390-2409] The State of Illinois, that there is three and one-half million liabilities with three million dollars in de-

posits. In the case of a state of that size, if it failed to cooperate, that would mean that you would have to eliminate from your assets \$3,000,000 and have to eliminate from your liabilities \$3,500,000 and build your plan over after taking the assets and liabilities. I may not have made that very clear; it is clear to my mind.

Q. What I am trying to get at, would it not affect each series of contracts?

A. Most certainly it would.

Q. What do you mean by that?

A. Well, in some of the states the deposits of securities is far in excess in a given fund of the liabilities. On the other hand, a deposit is far short of the liabilities. So that would throw you completely off on your theory of trying to organize by plan.

[fol. 2410] Q. About these expenses of operation, what about that?

A. Mr. Farmer, any estimate of expenses that we could make now anticipating a year's expenses would be—would have to be qualified in so many ways it might be a very wild estimate. I could give some notion on the basis of the present operation and the payroll.

Q. That is right. Tell us what the payroll is, what it will run annually on the present basis.

A. Present basis about \$84,000, about \$7,000 a month.

Q. On the present basis the annual payroll would be about \$84,000?

A. That is right.

Q. That is exclusive of any commissions to the trustee or counsel fee?

A. That is right.

Q. Then name the other principal expenses that would be incurred?

A. Well, your supplies and the—I don't know how many general notices we might have to give to creditors. I know [fol. 2411] when they send out 80,000 letters—

Q. Let's leave out notices to creditors.

A. Your supplies, I wouldn't hazard a guess as to what they would cost. Taxes on real estate, and then, contingent upon the outcome of this present suit in which we are appealing the income tax levy, it would be pretty hard to guess the income tax.

Q. What are the taxes on the home office building?

A. And insurance. I don't know.

Q. You estimated here last time that all those expenses in that category, with the salaries on the present basis, would amount to between \$125,000 and \$150,000 a year, didn't you?

A. Yes, as an estimate I would say.

[fol. 2412] The Court: I believe, in view of some testimony that was adduced or attempted to be adduced with reference to whether or not the attitude of state officials was a vital element in considering whether a plan could be devised, the Court would like to have statements on the record from representatives of those state officials, if they care to [fol. 2413] make them, as to whether or not they wish to cooperate with any plan that might be evolved in the state court receivership which would have as its purpose the reorganization of this company.

Mr. Palmer: If your Honor please, I have been the spokesman in this case on behalf of Mr. Sims, and from conversations I have had with him and the conferences with him and with Attorney General Meadows of the State of West Virginia, the attitude of Mr. Sims was that he would lend all possible aid in every way to a reorganization of Fidelity in the state court; that he felt—that he himself felt—if I could put it that way—that the state court receivers were part of his legal machinery to perform a reorganization; that he had attempted to work with the company in all possible ways to achieve a reorganization prior to instituting his suit; that he sent telegrams to all of the statutory officials in other states asking that they bring proceedings to hold in statu quo the assets of Fidelity and to protect them against suits or wastage, and that that was done in every state to which he wired after bringing his proceedings here, and that he himself felt that every attempt [fol. 2414] should be made in the state court to rehabilitate Fidelity as an insurance company, and that as to states outside of West Virginia, and as to contract holders both inside and outside of West Virginia, it should be a voluntary matter, and if a great enough percentage should agree to a reorganization that they who voluntarily agreed to it should be permitted to and those who did not choose to be reorganized should be permitted to liquidate;

that that should be a matter of individual concern to each policyholder without coercion by state officials or anyone else, and that those who desired that reorganization that everything should be done to attempt to form from the assets of Fidelity applicable to them some sort of insurance company, which would be a mutual company owned by those reorganized policyholders. Mr. Sims worked in every way toward that ultimate end. He felt that the state court proceedings, such as he brought, was a step that he was taking towards that end. If it were entirely impossible to get any appreciable number to agree, that then, of course, the question of liquidation would arise.

The Court: Now we have a statement of the attitude of [fol. 2415] Mr. Sims made on the record by Mr. Palmer, who, while he does not technically represent Mr. Sims here, I assume is speaking at least with the quasi authority of Mr. Sims.

Mr. Palmer: I think that would be a good expression, your Honor.

The Court: Now, how about the other states?

[fol. 2416] Mr. Schurr: Your Honor, I might say I appear here on behalf of Mr. Godfrey, Receiver in Missouri. I can't necessarily speak for Mr. Maloney, because I did not anticipate a question of this kind arising at the hearing here today; but judging from the conversations we have had with Mr. Maloney, the Commissioner of Securities of Missouri, he has one duty to perform, and that is the protection of the Missouri contract-holders. If reorganization is effected, any contract-holder that desires to go along with that reorganization, it is not for Mr. Maloney—and I am satisfied I can say this for him—he will not attempt to interfere with the desires of that contract-holder.

The Court: How could he, if he wanted to?

Mr. Schurr: That is right, he couldn't, but I mean by trying to convey to the contract-holder that reorganization should not be effected, such as Mr. Smith testified when I asked him what he meant by cooperation.

The Court: Do you think that means cooperation by Mr. Maloney in the plan?

Mr. Schurr: What?

The Court: What you have just stated.

[fol. 2417] Mr. Schurr: You mean let the contract-holder decide, without any statement whatever that might influence him?

The Court: Yes.

Mr. Schurr: I do. And also I think if reorganization is effected, and the reorganized company could comply with the regulations of the State of Missouri, I am satisfied Mr. Maloney would let them continue to do business in the State. Also he has a duty where certain contract-holders may not desire reorganization, to see that they are paid in accordance with the arrangement and deposit made with the State of Missouri to secure the payment of that contract-holder.

The Court: You do not mean to imply, though, that if reorganization is effected in the Federal Court instead of the State Court, Mr. Maloney would have any different attitude, do you?

Mr. Schurr: I don't think, your Honor, Mr. Maloney is particularly concerned about courts. I do say this, in the face of the turn-over order that was originally issued, naturally he became alarmed, because he was afraid deposits may be taken away that were placed there to protect Missouri creditors. Also I think there is great doubt in the [fol. 2418] minds of not only Mr. Maloney but others that there might be a very serious question of obtaining the necessary consent of the contract-holders in order to effect reorganization in the Federal Court, which would ultimately result in liquidation.

The Court: Then the extent to which the State of Missouri or Mr. Maloney is willing to cooperate is simply to refrain from saying to any contract-holders that they ought not to participate in the plan?

Mr. Schurr: Refrain from advising the contract-holder one way or the other, and seeing that the contract-holder in Missouri is finally protected as he has been protected in the past.

The Court: Any other statements?

Mr. Lauritzen: I think I might make a brief statement, your Honor, on the same conditions as Mr. Palmer, it being understood that the Banking Commission of Wisconsin is an administrative body consisting of three members, and that they have discretionary powers in these matters, which, of course, are beyond my control or that of any counsel representing them. However, I think I can fairly express [fol. 2419] the attitude of the Banking Commission in this matter as it stands since the commencement of proceedings in the West Virginia state court.

Fidelity has for a long time been under very strict surveillance of the authorities in Wisconsin. They conducted a rather extensive investigation of the company in 1938, and finally, after receiving assurances of one kind and another, the chief assurance being from Fidelity and from its counsel that the Wisconsin Trust Law was absolutely inviolate and that the company so considered it the State of Wisconsin let them go, so they ran from 1938 till early in 1941, when these present proceedings were instituted.

When we got the wire from Mr. Sims down here, of course it became obvious to Wisconsin that something had to be done, and promptly. We took the action that we believed our statutes contemplated, going into the circuit Court of Dane County and also giving notice to the officers and directors of Fidelity that the Banking Commission had taken possession of their Wisconsin assets pursuant to the terms of Chapter 215, which is the Building and Loan law of Wisconsin. It should be understood that in Wisconsin [fol. 2420] Fidelity is regarded as an investment association, but is subjected to the statutes relative to building and loan associations insofar as such statutes can be made applicable to this concern.

We then had conferences with Fidelity's counsel, who had been the counsel for some years out there, and also purported to act for the state court receivers after their appointment here, and an acceptable plan was agreed upon. We analyzed the statutes and—

The Court: You mean a plan of reorganization?

Mr. Lauritzen: No, a plan of procedure—

The Court: I am asking now the attitude of Wisconsin toward a plan of reorganization by the receivers of the Circuit Court of Kanawha County. That is all I am interested in your statement on the record now.

Mr. Lauritzen: I am leading to that.

The Court: Well, I beg your pardon. I didn't know you were.

Mr. Lauritzen: Let me say that we then instituted those proceedings, seeking, of course, to operate within the laws of Wisconsin and to institute such proceedings as were authorized under our statutes. Then they represented to us that they were desirous of reorganizing. Discussions [fol. 2421] were had with the Circuit Court of Dane County, the three members of the Banking Commission, Mr. Harlan

Justice came out to Madison, Mr. Goldsmith came out, who was of Koontz & Koontz, also counsel for the receivers here, and we told them that we recognized that under the building and loan liquidation statute that we proceeded under that there was definitely a provision for reinstatement. However, the court out there and the Banking Commission also recognized that something should be done to safeguard and freeze the interests of Wisconsin contract holders. At the then market value they were protected to the full extent of their cash surrender value; and the Court reasoned thus. He said, "It may well be that something can be worked out acceptable to contract holders and to the Banking Commission of Wisconsin, but can I sit here and while such things are being worked out, in view of the international situation and other things, affecting the securities market—sit here and see those securities decline in value? If they double in value Wisconsin people are not helped one penny, whereas if they decrease in value Wisconsin people lose just that much"—

[fol. 2422] The Court: Mr. Lauritzen, before you go ahead, what the Court is driving at—maybe you don't just get it—but there is a provision that will require me to decide some time here in passing on the question that is now before me whether or not there is a proceeding pending which would properly safeguard the interests of all creditors and others interested in this company. Now, in order for me to determine that I have asked this question as to what is the official attitude of these various states towards the reorganization plan of the receivers of the Circuit Court of Kanawha County, where that is pending. It seems to me that the attitude of the states toward their own contract holders would not help me a bit in the world. What I must know is, what is the attitude of the states towards a general, comprehensive plan, not with respect to protecting their own contract holders; but with respect to participating in a reorganization plan which would be comprehensive and involve the whole structure of this company? Now, what is the attitude of Wisconsin towards that? If you can clear that up, all right.

Mr. Palmer: If your Honor please, might I interrupt [fol. 2423] a minute? I was going to suggest this. I have just spoken to the gentlemen from Maryland and one from Ohio, and both of them say that they are not prepared,

as attorneys, to answer the Court's question; and I presume they would like to receive advice on that from the proper state officials, and I was going to suggest it might be a good idea to give time to them to contact their proper state officials, as I would like to contact Mr. Sims, and get that officially for the Court for the purpose the Court has asked. We understand the Court is asking what would be the attitude of each state as to the reorganization plans in the Circuit Court of Kanawha County.

The Court: Not what will it be, but what is it?

Mr. Palmer: That is right. And I suggest that we do get in touch with the proper person whom we represent, actually or quasi, and get their attitude and put it into the record.

Mr. Huwe: Your Honor, do we have to go to that trouble? These gentlemen have been in here for three weeks on the basis of some attitude of their particular client, and I don't see why they are not prepared to stand up now and say [fol. 2424] what their attitude is and what their clients' attitude is.

The Court: I am not going to require them to do it now, if they don't want to do it; and I beg Mr. Lauritzen's pardon for this interruption of his statement. If you want to, finish your statement.

Mr. Lauritzen: I think I understand more fully what the Court had in mind with respect to a West Virginia state court reorganization. We, at the outset of these proceedings declined to have any proceedings in Wisconsin that would be ancillary to the West Virginia proceedings. The only kind of a reorganization we recognized was at all possible was a reorganization of this company by us as a Wisconsin concern, leaving all the assets there and supplying capital in some manner or other, with a complete severance from any of the rest of Fidelity—that is, to have a separate entity out in Wisconsin. That was administratively discussed; it was discussed by Mr. Fleming and Mr. Messick when they came there, and they seemed to feel that that represented an enlightened attitude and to feel that we had given more constructive thought to it, [fol. 2425] and so expressed themselves; but as to any reorganization, whether it be in West Virginia or in the Federal Court, which would look to the destruction either of the authority of the State of Wisconsin over these

companies or the destruction of contract rights of contract holders in those deposits in Wisconsin, the Commission would not agree to it, and that is generally their position.

The Court: All right. I think we will take a recess. If there are any other statements that are short—

Mr. Farmer: Your Honor, I can only express my personal views about it.

The Court: You represent contract holders?

Mr. Farmer: Yes.

The Court: Then I am not interested in that at this time. Of course, your views would be considered and given their proper weight, but now I am asking about the attitude of the states.

Mr. Farmer: I just didn't want to be in the attitude of sitting mute.

Mr. Gray: I want to say briefly, your Honor, that the Securities Act of Illinois does not make provision broad [fol. 2426] enough, but to partly answer that question, it does give the authority to the Secretary of State, in order to preserve as far as possible the rights and interests of contract holders to liquidate such securities on deposit in that state by entering into contracts with any insurer or persons able to buy such securities in whole or in part.

Of course, the primary purpose of our officers out there is to protect their official bonds and to cooperate with anything which tends to carry out this Securities Law and protect their contract holders.

The Court: Can you tell me what the attitude of the State of Illinois is as to whether or not they would participate in a plan developed and evolved by the receivers appointed by the Circuit Court of Kanawha County, which would be a comprehensive plan affecting the whole structure of the company and involving a reorganization?

Mr. Gray: Well, as to the fact that it was in Kanawha County, I can see nothing objectionable about that. It would depend largely, I presume, on the plan and the effect it would have on the requirements on them as officers [fol. 2427] and the general courtesy which the contract holders would require. The fact that it was Kanawha County or whatever place—

The Court: That is just about equivalent to saying you don't know.

Mr. Gray: That is right. I am sorry I can't be more finite.

The Court: Well, we will go ahead and recess now until twenty minutes till four.

(At 3:31 P. M., a recess was taken until 3:40 P. M.)

After Recess

3:40 P. M.

The Court: I see the representatives of the State of Ohio and the State of Maryland are here. May I have some expression from them in regard to the question the Court asked?

Mr. Brown: May it please the Court, Mr. Eney and I have appeared specially for the purpose of filing a motion, which was argued the last day we were here. I have never talked to the Insurance Commissioner of Maryland relative to the subject to which your inquiry is addressed. I don't know the answer. If the Court desires me to con-[fol. 2428] tact him and find out, I shall be pleased to do so.

The Court: I will leave that to you, whether you wish to do it or not, but at present you don't know, then?

Mr. Brown: I don't know. I know things are held in statu quo in Maryland.

The Court: You are Assistant Attorney General?

Mr. Brown: No, Mr. Eney and I have been appointed as special counsel for the Insurance Commissioner of Maryland.

Mr. Dunifon: If the Court please, I think it would be improper for me to express any opinion of the Supervisor of Bond Investment Companies in view of the fact that he is not a party in this case and has filed no pleadings in this case. It might be of interest to the Court, however, that contrary to an opinion expressed this morning, or right after lunch, that the Superintendent of Insurance of Ohio, or Supervisor of Bond Investment Companies, has no discretion but to liquidate, the fact is that the Superintendent of Insurance has on numerous occasions in the past permitted statutory deposits to be freed to relieve insurance companies as part of the assets of a defunct company, after a [fol. 2429] reinsurance agreement had been concluded, and similar statutes have applied it to investment companies, so I think it only fair to say that the attitude of the official in charge of this type of company in Ohio, although he is

not in this case, can be judged by his past performance, in that he has co-operated in reorganizing insurance companies on numerous occasions.

The Court: You don't know what the attitude of the State of Ohio is as to whether the officials of that state would participate in a reorganization plan proposed, evolved or formulated by receivers of the Circuit Court of Kanawha County, West Virginia?

Mr. Dunifon: Would you care for my personal view on that, sir?

The Court: No, I just want to know whether you know about the attitude of your state.

Mr. Dunifon: Very frankly, sir, the matter of reorganization had not proceeded to any such stage that we had the feeling in Ohio that state court receivers would be able to accomplish reorganization. I accompanied Mr. White to Wheeling on that occasion that he met with the state court receiver, and we returned to Columbus with the definite [fol. 2430] thought in mind that no particular progress had been made with reference to the reorganization. I am not critical of the fact that the state court receivers did not have that information, but that was the sole purpose of our visit. So far as legal advice to the state officers in Ohio that would have charge of either co-operating or assisting in working out a reorganization in Ohio, I would say that they would be advised to co-operate in a reorganization plan that salvaged more for the contract holders in Ohio than they would otherwise receive under a liquidation, whether that be in state court or federal court.

The Court: It was your present opinion, as I understand it, that no progress had been made on any such reorganization plan?

Mr. Dunifon: That was our inclination; yes, sir—our opinion.

Mr. Palmer: If your Honor please, in view of the Court's rephrasing the question, and having in mind I think Section 146, sub-section 3 of 4—

The Court: Sub-section 4.

Mr. Palmer: You have stated it that "A prior proceeding [fol. 2431] is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding." I am wondering if the Court's question should not be corrected as of June 6th,

which is the time the petition in this Court was filed, and whether at that time it was in good faith; because at that time a prior proceeding was pending in which the interests would be best subserved. Now, of course, it might be that this proceeding which has gone on for some time since June 6th, would continue sometime in the future and that from time to time the answer to the Court's question as to what is now the opinion of the states as to whether the Circuit Court officials of Kanawha could form a reorganization plan might change, so I think the Court's question should be directed to the day mentioned, whether there was at that time a proceeding then pending which could have subserved and so forth. I am suggesting that to the Court because I realize—

The Court: I think you are right about that, Mr. Palmer, and I believe that the answers have indicated that there has been no change in attitude. If otherwise, I would like for [fol. 2432] you gentlemen to state it now.

Mr. Palmer: I think I might suggest to the Court that Mr. Sims' answer is on the record to the effect that he did not believe a face amount securities company could be reorganized, and that so long as certain persons who had been connected with the old company had anything to do with the new company he would do all in his power not to permit it to serve in the State of West Virginia, and that answer should be included. I would rather his answers would speak directly for themselves than my interpretation of them.

The Court: All right. Now let's go ahead with the testimony.

Mr. Palmer: If you- Honor please, I have here a Senate Committee print of an Investigation of Concentration of Economic Power, Temporary National Economic Committee, Monograph No. 28, Study of Legal Reserve Life Insurance Companies, a study made under the auspices of the Securities and Exchange Commission for the Temporary National Economic Committee, Seventy-Sixth Congress, Third Session, Pursuant to public resolution No. 113 (Seventy-fifth Congress), authorizing and directing a select [fols. 2433-2443] committee to make a full and complete study and investigation with respect to the concentration of economic power in, and financial control over, production and distribution of goods and services. This report is made to Senator Joseph C. O'Mahoney, Chairman of the

Temporary National Economic Committee, the monograph having been written by Gerhard A. Gesell, Special Counsel of the Insurance Section of the SEC, and Ernest J. Howe, Chief Financial Adviser, Insurance Section, Securities and Exchange Commission, and being based, with footnotes showing where it is so based, upon a full and complete public hearing on the matter.

(There was a discussion off the record.)

Mr. Palmer: May I state on the record that the particular parts which I think are relevant are pages 96 to 101; then Chapter 10 on "Company Retirements—Reinsurance and Failures"; Chapter 13, "Classes and Types of Life Insurance Sold"; Chapter 14, "Policy Terminations"; Chapter 15, "Agency Practices"; Chapter 20, Part B, "Annuities"; Chapter 21, "Assets and Investment Practices"; B "Cash," C "Bonds," D "General Investment Considerations."

[fol. 2444] HARLAN JUSTICE called as a witness for the state court receivers, having been duly sworn, testified as follows:

[fol. 2445] Direct examination.

By Mr. Palmer:

Q. Tell the Court your name, please.

A. Harlan Justice.

Q. Where do you live?

A. Charleston, West Virginia.

Q. What is your occupation?

A. I am Deputy Insurance Commissioner, State Auditor's office.

Q. How long have you occupied that position?

A. Over eight years.

Q. And who has been the auditor under whom you have been employed?

A. Edgar B. Sims.

Q. Have you been in office during the entire time that Mr. Sims has been in office?

A. Yes, sir.

Q. Have you from time to time advised with Mr. Sims about Fidelity Investment company?

A. Yes, sir.

Q. Were you at a meeting of the various securities commissioners of the various states of the United States held [fol. 2446] in Chicago in June of 1941?

A. Yes, sir.

Q. Will you give the Court an indication or idea of what states were represented and, not the name of the person, but the title of the person who was present at that meeting?

A. Well, there were representatives from Indiana and Illinois, Wisconsin, Ohio, Maryland. I don't know—there must have been ten states represented there by somebody from the securities department or attorney general's office or insurance department.

Q. Had there been a meeting just prior to that time in the City of Detroit of the Association of Insurance Commissioners, or whatever the name of it is?

A. There is a National Association of Insurance Commissioners.

Q. And had they had a meeting in the City of Detroit just prior to that time?

A. Yes, sir.

Q. Tell the Court whether or not at that meeting in Detroit it was learned, or shortly thereafter learned, that there had been a federal court proceeding instituted concerning [fol. 2447] Fidelity, and whether or not the Chicago meeting was the outgrowth of that with the states who were interested in Fidelity being there represented to a large extent.

A. Mr. Sims and I learned about this meeting of these state representatives in Chicago while we were in Detroit, and we called the office here to see if Mr. Brown had received an invitation or request to be present and so on, which he said he had not received, and the Auditor had to leave and come back to Charleston, and he asked me to attend that meeting.

Q. Was that a meeting of officials of the states who were interested in Fidelity?

A. Yes, sir.

Q. Tell the Court whether, at that meeting, appeared Mr. James Fleming?

A. Yes, sir.

Q. At the meeting in Chicago?

A. Yes, sir.

Q. That is the Mr. James Fleming who is here—who is not here today, but has been here present representing the debtor, Fidelity Assurance Association?

[fol. 2448] A. I understand he is the same man, yes, sir.

Q. Will you tell the Court just what Mr. Fleming informed you gentlemen representing the various states at that meeting?

Mr. Ray: I object to that, your Honor.

The Court: On what ground?

Mr. Ray: Well, that certainly would be hearsay. We can get Mr. Fleming here.

Mr. Palmer: We are asking him what he heard Mr. Fleming say. There is no hearsay about that.

The Court: I overrule the objection.

Mr. Palmer: Go ahead. Repeat the conversation as nearly as you can.

A. Well, this meeting was called, I understand, by Mr. Jarecki.

Mr. T. C. Townsend: I can't hear you.

A. (Continuing.) He was chairman of this meeting, and it was called for the purpose, my understanding was, to discuss this situation that had arisen with these various state deposits after this federal procedure had been begun, and the meeting had been in session just a short time when [fol. 2449] Mr. Fleming made an appearance, and told these men that he had been brought into this matter by the stockholders, particularly Mr. Marshall; and Mr. Marshall and his family were the principal stockholders in the company and it had been in their family for many years, and that under the states' procedure that it was very apparent that the matter was headed direct for liquidation, and that they didn't want to see the company liquidated because it would be a great loss to most of the people who had their money in it, and that they had brought him into the case and this federal procedure had been brought, and that he also stated that—that he and Mr. Messick had been retained for the purpose of working out a reorganization plan.

Mr. Palmer: Retained by whom?

A. By the trustee.

Q. All right; go ahead.

A. And that they were going to proceed to work out such a plan. Well, there was quite a number of people shot a lot of questions at him. They were particularly interested in these deposits, and they understood that there had been a court order entered which required the states to turn over these deposits, and they asked Mr. Fleming [fol. 2450] if he would enter an order—or prepare an order and present it to the courts waiving that in some way. I didn't understand—I am not a lawyer and I didn't understand the exact purpose of it. Well, the way I got it he didn't agree to do that, but he did agree, before he left the meeting, to try to work out some informal conference with these various state representatives and the Court—said he would try to do that.

Q. Was there anything asked him concerning his attorney's fee in the federal court proceedings and his employment by the trustee?

A. Yes, somebody popped him with a question about fees. He said well, that the State of West Virginia was not a wealthy state, and he thought, that all things being taken into consideration, that the fees would be reasonable.

Q. Did he say whether or not he expected the federal court to set his fee for that work for the trustee or whether the trustee would pay him; or did he mention that?

A. I don't recall that he mentioned that.

Q. What was the date of this meeting?

[fols. 2451-2453] A. It was Friday the 13th.

Q. Of what month?

A. June.

Q. And where was it held?

A. In the LaSalle Hotel.

Q. In what city and state?

A. Chicago.

Q. Chicago, Illinois?

A. Yes.

Q. How long was Mr. Fleming there present with you?

A. Well, I should say about an hour—an hour or so.

Q. Was Mr. Messick then present?

A. I didn't see him, no, sir.

[fol. 2454] Mr. Justice, I don't want to lead you, but I do want to get further information about that meeting in

Chicago. Mr. Fleming appeared at that meeting and explained how he originally became interested in Fidelity? Is that right?

A. Yes, sir.

[fol. 2455] Q. And then he told you that at that time he and Mr. Messick had been employed by the trustee of Fidelity.

Mr. Ray: Your Honor, I am going to object to this type of direct examination.

The Court: He has already testified about those things. Why ask them again?

Mr. Palmer: I am leading up to another subject.

The Court: I don't think you have to do it by repeating what has already been testified to.

Mr. Palmer: All right.

Q. Now, I want to ask you this: is there any doubt at all as to your memory of Mr. Fleming's statement concerning his connection with the trustee?

A. No, sir.

Q. Tell us in substance whether the conversation dealt with matters relating to Fidelity and what would have to be done by virtue of the Federal Court proceeding, and if you can detail as much of those conversations as you can remember.

A. Well, the major question, and the one that was discussed all around, was the status of these deposits—

The Court: Which conversation are you talking about? [fol. 2456] Mr. Palmer: Between Mr. Fleming and the gentlemen at this meeting at which Mr. Justice was present.

The Court: I will let you develop Mr. Fleming's statements so far as they relate to this particular question that you seem to be referring to; his employment by the trustee and so forth, but I think it would be improper to detail any conversations that took place among those representatives at that meeting. That would be so clearly hearsay—

Mr. Palmer: Oh, yes. I only meant the conversations between Mr. Fleming and any of those gentlemen.

The Court: Well, so far as they are pertinent.

Mr. Palmer: Yes. Go ahead.

A. Well, the major point that was on everybody's mind seemed like that was in this meeting was the status of these deposits that were held by the various states.

Q. Were they questioning Mr. Fleming about that?

A. Yes.

Q. And was he answering about it?

A. Well, they were more interested in trying to get him to agree to amend his—at least, to bring some papers into [fol. 2457] court amending the Court's order about the transfer of these deposits over to a trustee.

Q. Let me ask you this, to refresh your memory on it. Was anything said by Mr. Fleming as to his ability to reorganize a company, and did he give any examples of other company reorganizations in which he had taken part to indicate his ability?

A. Yes, he told this meeting that he had been connected in some way with the reorganization of some—Wayne Pump Company, I believe he called it, and seemed to point to that as having been a very successful reorganization.

Q. May I ask why he related his connection with that reorganization?

Mr. Ray: May it please your Honor, this is not relevant to this case. Mr. Fleming is not a party in interest.

The Court: It may have some bearing. I will overrule your objection. However, that particular question is objectionable. You are asking this witness why Fleming did that.

Mr. Palmer: Well, I meant was it in answer to a question [fols. 2458-2482] tion.

Q. Was there a question asked concerning Mr. Fleming's ability to help reorganize, or did he volunteer his explanation of his ability to reorganize?

A. He volunteered it.

Q. He volunteered it?

A. Yes, sir.

[fol. 2483] FRED RISLEY called as a witness, having been duly sworn, testified as follows:

[fol. 2484] Q. What is your name?

A. Fred Risley.

Q. Where do you live, Mr. Risley?

A. At the present time at Pleasantville, New Jersey.

Q. What position do you hold with the Fidelity Assurance Association?

A. I was elected president in April, 1940.

Q. How long have you been connected with that company, Mr. Risley?

A. A little over seventeen years.

Q. Will you tell us what various positions you have held with the company?

A. I started in as a salesman in the Washington, D. C. office, was made associate manager of that office, and that was all in 1924. In February, 1925 I was elected secretary-treasurer and made my headquarters after that in Wheeling, and subsequently I was made vice-president and secretary and—

Q. Can you give us the date of that, please?

A. I would say 1927 or 1928, and then I was elected executive vice-president along the latter part of 1939, and [fol. 2485] president in April, 1940.

Q. When were you first elected to the board of directors of Fidelity, Mr. Risley?

A. I believe about 1927.

Q. And served continuously since that time?

A. No.

Q. For what interval were you not on the board?

A. I believe there were two intervals that broke up my continuous service. I do not remember the date.

Q. Could you give us approximately how long they were or when they were?

A. I believe one interval lasted nearly a year.

Q. Beg pardon?

A. I believe one interval lasted nearly a year and the other one—oh, probably eight or nine months.

Q. Are you a stockholder, either preferred or common, of Fidelity?

A. I hold both.

Q. And will you tell us how many shares of each you hold?

A. Three hundred and sixty-seven shares of common; I think about twelve shares of preferred.

[fols. 2486-2513] Q. How long have you been a stockholder of Fidelity?

A. Since 1925.

Q. Mr. Risley, as president of Fidelity, were you fairly familiar with all of the various details of Fidelity?

A. Well, as much as it was humanly possible to be, yes.

[fol. 2514] Q. Do you know when Mr. Arthur Koontz first became associated with Fidelity?

A. It would only be a guess. I would say somewhere around 1928.

Q. I think the record will show it was around 1932. Again I am not attempting to state accurately on that.

A. Well, I don't know definitely.

Q. When did he first become active as an attorney in the affairs of the company?

A. I wouldn't be able to recall that.

[fol. 2515] Q. Isn't it a fact that he really became active in the affairs of the company to a major extent after the SEC suit was brought in Detroit in December, 1938?

A. I think that is a correct statement.

The Court: Who got him in, Mr. Risley?

A. I believe Mr. Marshall was instrumental in that.

Mr. Palmer:

Q. State whether or not you were familiar, and if so to what extent, with the activities of Mr. Koontz and his firm on working on the defense of that SEC suit in Detroit in 1938.

A. Well, I was with the legal staff in Washington day and night during that preparation.

Q. Did Mr. Koontz actively work on that matter?

A. He did.

Q. Were there any other members or associates of his firm who worked with him?

A. There was a Mr. Goldsmith and I believe Mr. Lambert. I am not sure whether he was in Washington or not; those days are rather confusing and hazy.

Q. Was Mr. Ross Thomas there?

A. I believe that—yes, I am pretty sure that he was there.

[fol. 2516] Q. Isn't it true that immediately after that suit was brought you, together with Mr. Koontz, Mr. John Marshall and others of Mr. Koontz's firm, worked practically day and night for some time in defense of that suit and getting ready to defend it?

A. Yes, sir; that is correct.

Q. And how long a time was it, would you estimate, that you worked so heavily?

A. Well, on the SEC case and the preparation of the registration forms for Fidelity and its subsidiary, I would say that he was very active on it for two or three months.

Q. During the period immediately following the institution of that suit, when you say that you were working practically day and night, were Mr. Koontz and his legal associates working with you practically day and night?

A. They were when they were with me, yes.

Q. And were they with you for any considerable extent of time at that time?

A. In Washington, yes.

Q. After that SEC suit in the early part of 1939, was [fol. 2517] there not a receivership proceeding brought against Fidelity in Wheeling?

A. That is correct.

Q. I believe that Mr. Tom Foulk is the local counsel, or was the local counsel, of Fidelity. Is that correct?

A. That is correct.

Q. And also at that time there was specially employed Mr. Austin V. Wood as local counsel?

A. That is right.

Q. And isn't it also true that Mr. Arthur Koontz and the other members of his firm of whom you have spoken came to Wheeling to participate in that suit?

A. They spent two or three weeks there, if I recall correctly.

Q. And isn't it true also that they spent some time in preparation before they went into Court?

A. Yes.

Q. And they worked with you and the other officers of Fidelity?

A. That is correct.

Q. And isn't it further true that after that suit was [fol. 2518] brought there was an appeal of it to the Fourth Circuit Court of Appeals?

A. There was an appeal, yes.

Q. And isn't it true that Mr. Koontz and his associates worked on that?

A. That is correct.

Q. And wasn't that considerable work that was done at that time?

A. I would think so.

Q. You were in constant touch with them during all this time and during all this work, weren't you?

A. I was.

Q. And they were working directly with you and other officers of the company?

A. That is correct.

Q. Up until this SEC suit, while they might have occasionally rendered sporadic services, the firm of Koontz & Koontz had not been actively working with Fidelity? Isn't that true?

A. That is correct.

Q. Mr. Tom Foulk and Mr. Marshall were the—if I may call them—local and general counsel—and from time to time [fol. 2519] other attorneys where it was necessary were called in to render services, including Koontz & Koontz? Isn't that true?

A. For legal cases, yes.

Q. On certain tax cases various other firms, like Mr. Marshall's firm in Washington, were called in?

A. Yes.

Q. Mr. Risley, in connection with preparing the registration for SEC, do you know or can you tell us how much work Koontz & Koontz and particularly Mr. Ross Thomas, did on that particular matter?

A. They prepared the entire registration statement, with the exception of the figures which were furnished by Haskins & Sells.

Q. Was that a voluminous report?

A. I would consider it quite so.

Q. About an inch and a half thick of printed pages?

A. About the thickness of a New York telephone book.

Q. And about the same size?

A. Well, it is longer.

Q. Can you tell us of your own knowledge, the extent of time which it took to prepare that? In other words, [fol. 2520] was it a week or month or did it extend over a period of weeks or months or how long did it take, to your knowledge, from the start to the finish of preparing that?

A. My recollection would be about two and one-half to three months.

Q. And that was constant work?

A. From the time it was started until it was finished, yes, sir.

Q. Do you know whether Mr. Ross Thomas devoted practically all of his time to that one thing?

A. I was told that he had been assigned to that; I don't know myself.

Q. Did you work with him on occasions and give him information?

A. Yes.

Q. And was that frequent during that period?

A. Oh, four or five times I would say during that period.

The Court: Let me ask Mr. Risley the general tenor of that booklet which you say was a little larger than a New York telephone directory. Was it for the purpose of under-[fol. 2521] taking to persuade the Securities and Exchange Commission that the Fidelity company was a good company and the kind of a company that should be permitted to do business, a solvent company and all that?

A. No, sir.

Q. What was it?

A. It was on the forms furnished or in the manner prescribed by the regulations of the Securities and Exchange Commission for registration of companies with them.

Q. I want to find out what the purpose of that booklet was.

A. It is a statement of the history of the company and financial statements for a period of three years.

Q. Why was it to be submitted?

A. That was part of the consent decree or arrangement made with the Securities and Exchange Commission at the time of their suit.

Q. I understand that, but I want to know what the purpose of that booklet was. What were you trying to convince somebody of by that book?

A. We were not trying to convince anyone of any thing, [fol. 2522] I think.

Q. Then why go to a lot of expense to prepare it?

Mr. Palmer: If your Honor please, that is a legal question.

The Court: Mr. Palmer, will you let me finish?

A. That is the regulations prescribed by the Securities and Exchange Commission. Any company registering with them must furnish a certain amount and type of information for the purpose of registering.

Q. Isn't it for the purpose of convincing the Securities and Exchange Commission that this company is a proper company to be permitted to sell its securities to the public?

A. Well, as I understand the Act, your Honor, the Securities and Exchange Commission doesn't pass on the quality of the registrant. They simply require you to furnish this factual information so that the reader can determine for himself whether or not he wishes to purchase the bond, stock, or other security that is being issued by the registrant company. It is purely a factual statement.

Q. Well, I understand that, but when you have furnished [fol. 2523] that, then the company has some interest in whether the Securities and Exchange Commission registers the company or not, hasn't it?

A. Well, as I say, as I understand the Act they have to register even an insolvent company if it applies for registration. I think what you have in mind, Judge, is the prospectus that is submitted to the public when they are solicited to purchase the securities of the company. That is a different document entirely from the registration papers. It contains various parts of the registration statement and refers to the balance of the registration statement for the part that is left out.

Q. Then there would be no purpose on the part of the company and there was no purpose on the part of the Fidelity company in submitting that large book, to have it show that the company was a desirable company to do business?

A. Well, it is simply to show the degree of solvency of the company for the past three years prior to the date of application for registration.

Q. Well, did it show that the company was solvent for the [fol. 2524] past three years?

A. Yes, sir, based on the sound market values—on the market basis there was a shortage, and that was the information that we were required to disclose to the public through the prospectus.

Q. Was a prospectus submitted along with that large book?

A. One was prepared, yes, sir.

Q. Who prepared that?

A. Koontz & Koontz, with the assistance of the staff again.

Q. Was that through Mr. Thomas?

A. Yes, sir, Mr. Thomas, Mr. Goldsmith—they all worked on it I believe.

Q. Let me ask you the same question with reference to that prospectus that I asked you awhile ago with reference to the booklet. What was the purpose of that prospectus?

A. To be used in the solicitation of the sale of our contracts and to furnish the prospective purchaser with full information concerning the financial condition of the company.

[fol. 2525] Q. Was it one of the purposes of the prospectus to show that the company was a desirable company in which to invest and that it was a solvent company?

A. The purpose of the prospectus, your Honor, was simply to disclose the actual condition as it existed. You see, the amount of so-called selling material or sales talk was quite limited and is quite limited yet in any prospectus.

Q. Limited by whom?

A. The SEC regulations.

Q. Then it was the purpose of the prospectus so far as it could comply with the SEC regulations to present this company in the light that I have spoken of?

A. Yes, sir.

The Court: All right. Go ahead, Mr. Palmer.

Mr. Jaegerman: May I make one statement, your Honor, that this registration statement and prospectus were never filed with the Securities and Exchange Commission.

Mr. Palmer: Why not be fair and tell how many conferences and how long it went over? The Securities and Exchange Commissioners informally met and they couldn't [fol. 2526] agree among themselves.

Mr. Jaegerman: I don't think that is true, your Honor. I think I would have been told about it if it had been.

Mr. Palmer: Why don't you tell the Court the whole proceedings? I am going to ask the SEC, which I had earlier when I interrupted the Court—for which I beg the Court's pardon—to inform the Court of the law of 1933 as to why this had to be filed. It was a legal matter and it was necessary for Fidelity to file it. I would like for the gentlemen from the SEC to explain to the Court the legal reasons why it had to be filed. Mr. Risley only knows the general answers, of course.

The Court: I think that is apparent, the reason it had to be filed. The purpose of my question, as you probably

saw, was to find out just what the connection of the firm of Koonitz & Koontz, and particularly Mr. Ross Thomas, was, and what attitude he took at that time toward the company, to see if that has any bearing on his suitability as a receiver, particularly.

Mr. Palmer: Will the gentlemen from the SEC be glad [fol. 2527] to put into the record the particular section of the law under which it was necessary to prepare and file a registration statement, the Act of 1933, I believe?

Mr. Reinhardt: Section 5.

Mr. Palmer: And might they also state in the record the difference that occurred in the Investment Companies Act of 1940, which may or may not have rendered the report unnecessary after it had been prepared, for the reason why it wasn't filed?

Mr. Reinhardt: If your Honor please, if it was necessary to file this report under the Act of 1933 it should have been filed in 1934, or at least long before—well, the end of 1933 or early in 1934, or at least a great deal sooner than it was filed—than it was prepared, I should say; it was never filed. I have here a photostatic copy of a letter signed by Mr. Marshall which I procured in response to a request from Mr. Farmer, which shows that as early as October 15, 1935, the question of the necessity for filing such a report was raised, and the company said that it claimed an exemption under sub-division 8 of Section 3-a of the Securities Act of 1933. Sub-division 8 provides—

[fol. 2528] The Court: I think that was read by Mr. Palmer already.

Mr. Reinhardt: I think that is true.

In 1940 the Investment Companies Act went into effect, and that contains entirely different provisions for filing documents with the Commission, and no forms have yet been formulated under that Act, except a form which consists of a notification of intention to register under that act, but no form of registration statement under the 1940 Act has been gotten up. Now, if there is anything Mr. Palmer—

Mr. Palmer: Yes, I would like to ask that what Mr. Risley has stated, that the consent decree provided that the company should file such a report, which it had not filed, as you say, in 1934, under the requirements of the Act, and that that is the reason the company was then preparing it.

Mr. Jaegerman: Your Honor, the consent decree, of course, speaks for itself. It is in evidence. There is noth-

ing in the decree that even mentions a registration statement. However, at the time that that complaint was filed [fol. 2529] in Detroit the company's attention was called to the fact that there wasn't a registration statement on file and that in the opinion of the Commission there should be a registration statement if the company intended to continue to sell its contracts; and the company voluntarily assumed the responsibility for having a registration statement on file with the Commission in the very near future.

Mr. Warner: Your Honor, perhaps I can from my own experience before the Securities and Exchange Commission answer the Court's question as to the purpose of a registration statement.

The Court: Mr. Warner, let's wait until after recess for that. We will recess Court until 11:30.

(At 11:20 A. M., a recess was taken until 11:30 A. M.)

After Recess

11:30 A. M.

Mr. Reinhardt: If the Court please, while we are on that subject of the registration statement, Mr. Risley can explain just why the registration statement was gotten up and why it was never filed, and I would like to ask him to do that.

The Court: All right. I interrupted Mr. Warner when I recessed the Court, and I just wanted to explain to Mr. [fol. 2530] Warner that the Court's question was not directed at the legal purpose of the statement, but the purpose the company itself had in mind. And now if Mr. Risley can further enlighten the Court on that, I would be glad for him to do it.

A. The purpose of preparing that form was to comply with the registration regulations and requirements of the Securities and Exchange Commission, and it was prepared solely with that thought in mind.

Mr. Reinhardt: May I ask, Mr. Risley, you referred to a period of two or three months during which you worked with counsel on this statement. When was that?

A. I would say that it began immediately after the conclusion of the bankruptcy proceedings in the federal court in Wheeling.

Q. You mean receivership proceedings?

A. Yes.

Q. When was that?

A. I believe it started about the first part of January—January 10th or 13th or somewhere along there.

Q. Those were the receivership proceedings?

A. Yes.

[fol. 2531] Q. I refer to the two or three months period. When did that start?

A. As far as I know it ran from somewhere around March up until some time in June.

Q. What year?

A. 1939.

Q. This conference that has been mentioned, when did that occur?

A. To the best of my recollection sometime in the summer of 1939, in July or June, somewhere along in there. I don't know exactly when it did occur.

Q. Who participated in that conference?

A. Mr. Koontz represented the association, and as I recall he told our board of directors that Mr. Lane—

Q. Who is Mr. Lane?

A. General counsel for the Securities and Exchange Commission, and Mr. Klein, who is I believe assistant counsel and some other person of the legal department of the Commission whose names I do not recall.

Q. Did he report on what happened at that conference?

A. He did.

Q. What was his report?

[fol. 2532] A. He reported that there was a difference of opinion concerning the applicability of the Bartlay Investment Trust Indenture Act if the association registered under the 1933 Act with the Securities and Exchange Commission, and he reported to us that the Commission—or this conference was divided as to whether or not it would have any effect on the association.

Q. And what was his recommendation?

A. And under those conditions he recommended that we not file the registration statement which we had prepared.

Q. Was anything further done about it?

A. Not to my knowledge.

The Court: Go ahead, Mr. Palmer.

Mr. Palmer: Let me ask you, Mr. Risley, if that conference of which you are speaking did not take place in the summer of 1940 rather than in the summer of 1939, and if the Investment Companies Act of 1940 had then either been passed or was in progress of being passed by Congress?

A. I believe that I have made a mistake on that year. I believe it was 1940, because there was not a gap of eighteen [fol. 2533] months; I am sure of that; so it must have been the summer of 1940.

Mr. Reinhardt: Wait a minute, Mr. Risley.

Mr. Palmer: Mr. Reinhardt, would you mind if I finished my examination and then cross-examine—

Mr. Reinhardt: I would, because this is a particular question that relates to the Securities and Exchange Commission, and I would like to get the facts in the first instance.

Mr. Palmer: Your Honor, I object to that, because—

The Court: I think Mr. Palmer ought to be permitted to go through, so I sustain the objection to the interruption.

Mr. Palmer:

Q. Mr. Risley, I was asking you about the preparation of this report, and the Court asked you some questions concerning it. Was it a report that you gathered the SEC required that the company file?

A. It was in accordance with the forms furnished by them.

Q. And it has been stated here by Mr. Jaegerman that either prior to or during the SEC suit in Detroit there was an informal conference at which the company voluntarily [fol. 2534] agreed, because of the insistence of the SEC, that they would furnish the report, even though perhaps they had not felt before that they should. Is that correct?

A. That is correct.

Q. In other words, there is a letter in evidence here by virtue of which the company believed it was exempted from filing this report. During the conference with the SEC in the latter part of 1938 or around the time the Detroit suit was filed—there was an agreement reached whereby the company voluntarily said that even though it had formerly objected, they would prepare and file the registration report?

A. Yes.

Q. And that was at the request and insistence of the SEC?

A. That was one of the conditions the association agreed to.

Q. And there was much work, both by you in getting the necessary information and by the firm of Koontz & Koontz in preparing the legal end of it, in order to get that report prepared? Is that correct?

[fol. 2535] A. That is right.

Q. Now, can you tell me whether or not there was filed under the 1940 Investment Companies Act the intention to file a registration that Mr. Reinhardt spoke about?

A. Yes, there was.

The Court: Excuse me, Mr. Palmer. Before you leave that, tell us what this Trust Indenture Act was, when it was passed.

Mr. Palmer: I believe the gentlemen from the SEC could do that.

Mr. Reinhardt: That was an act that was passed and became effective in 1939, your Honor, which contained provisions relating to the contents of a trust indenture, directed at things like exculpatory clauses and so on. I do not have a copy of that statute with me, I will be glad to provide a copy to the Court.

The Court: All I am interested in knowing is whether I have a correct understanding. On the passage of the Bartley Trust Indenture Act and consideration of that by Mr. Koontz, Mr. Koontz gave advice to the company that the registration forms which had been prepared not be filed. [fol. 2536] Was that the idea?

The Witness: That is correct, yes, sir.

The Court: They had already been prepared before the passage of the Bartley Act?

A. It was being prepared at the time the Bartley Act was passed by Congress.

Mr. Reinhardt: As I understand it, that is the testimony, your Honor. The question was whether the company would come within the provisions of the Bartley Act by filing this registration under the 1933 Act.

The Court: Of course, the question in the Court's mind was, if Mr. Koontz finally concluded that it ought not to be filed, why hadn't he reached that conclusion before he ever started the preparation of it. The witness says that the

explanation of that is that when the preparation was started the Bartley Act had not been passed, and after the passage of the Bartley Act Mr. Koontz considered that perhaps the filing of the registration would bring the company within the Bartley Act, and they didn't want to be brought within it and therefore recommended that it be not filed.

Mr. Palmer:

Q. Is that correct, Mr. Risley, what the Court has just [fol. 2537] stated?

A. Yes, as I understand it it is.

The Court: Now you may go ahead.

Mr. Palmer:

Q. In other words, further on that, by the regulations of the SEC and the laws of Congress it was thought and felt necessary by you and Koontz & Koontz, your attorneys, and so deemed necessary by the SEC, that you prepare and file this registration statement. Is that correct?

A. That is under the 1940 Investment Companies Act?

Mr. Palmer: No, 1933. Read the witness my question.

(The question was read.)

A. I might say that we agreed to file that registration statement, not that we believed it was proper to do so.

Q. But you agreed to at the insistence of the SEC?

A. We had a special meeting of the—I believe it was the executive committee—in the City of Washington, and furnished the Commission with a certified copy of the resolution in which we agreed to file a registration statement as soon as it was possible to prepare it.

Q. At whose office was that meeting held? Mr. John [fol. 2538] Marshall's?

A. I think that it was held in the Mayflower Hotel. I can't recall.

Q. Did Mr. Marshall or Mr. Tom Foulk participate in all these deliberations or a majority of them?

A. You mean with the Securities and Exchange Commission?

Q. Yes, or the deliberations about the action that was necessary for the Securities and Exchange Commission.

A. Mr. Foulk was in Wheeling, if I recall correctly; I

don't think he participated at all; and I am sure that Mr. Marshall did not.

Q. After this agreement and resolution, then you went ahead and began your work of preparing the statement. Is that correct?

A. After the bankruptcy proceedings were settled then we could start to work on that.

Q. And then by the time you had it finished, there had been a new Act of Congress passed, and a conference was had with certain gentlemen and counsel of the SEC concerning the effect of it on this registration if filed. Is that right?

[fol. 2539] A. That is right.

Q. And Mr. Koontz reported to the board of directors' meeting that the conference with the gentlemen from the SEC which you have related resulted in them, the SEC, disagreeing, some believing that it would be proper to file the registration and some believing it would not, and he came back and reported that to you and advised that under the circumstances it not be filed. Is that correct?

A. It wasn't the question of the propriety of filing; it was the question of whether or not the Bartley Act would become effective on the association if that registration statement was filed; and inasmuch as the company had definitely committed itself to file that registration statement, Mr. Koontz thought it was necessary and only proper that the thing should be submitted to the board of directors and they determine whether or not we should file.

Q. And what did the board of directors determine?

A. And they accepted his recommendation not to file the registration statement.

Q. That was after a full explanation by him of the [fol. 2540] law and the conferences and so forth? Is that correct?

A. That is right.

Q. So that the final action was by the board of directors?

A. Or the executive committee. I think it was the full board of directors; the minutes will show.

Q. What, if any, work was performed thereafter in getting ready this intention to file under the 1940 Act that you have talked about?

A. Koontz & Koontz prepared that, together with applications for each individual officer and director for waiver

under a certain section in the Act, I don't recall the number.

Q. And was that in pursuance of a meeting of the board of directors or the executive committee?

A. Yes, sir.

Q. And had the matter been fully discussed and the law given by Koontz & Koontz as counsel and the ultimate decision left either to the board of directors or the executive committee before it was undertaken?

A. Yes, there wasn't much discussion permitted for directors, because the Act required us to register—or rather [fol. 2541] to file an intention to register.

Q. Do you know how long Koontz & Koontz worked on that particular matter?

A. No, I do not recall.

Q. Would you give us an idea as to how frequently you or other officials of the company called upon or engaged the services of either Mr. Arthur Koontz or his firm from the filing of the SEC suit on up until the filing of the receivership suit in April of this year?

A. Well, it was a diminishing demand on Mr. Koontz and his firm's time. Immediately following the SEC case in 1938 he was called on, I would say, without any question, daily for advice.

Q. And nightly?

A. And nightly, yes, sir, and after that—after we became adjusted to the new order, so to speak, the demands on his time and Mr. Thomas's and Mr. Goldsmith's diminished.

Q. Now, Mr. Risley, after the passing of the Investment Companies Act of 1940 did you study the terms of that Act and confer with Mr. Foulk and Mr. Marshall and Mr. Koontz, the company's attorneys, about the effect of that [fol. 2542] Act upon the company?

A. I did.

Q. State whether or not from those conferences it became apparent to you that the company could not do business under that 1940 Investment Company Act.

A. It did.

Q. Is it true that the Investment Companies Act provided a loading of approximately \$87.00 as the total amount for each contract, and you felt that it would be impossible to operate and sell at such a loading?

A. No, that is—wasn't the reason that we couldn't do business under the Investment Companies Act of 1940. It

was the reserve requirement which it was impossible for the association to meet.

Q. And didn't the cutting down of the loading have something to do with it as well in your considerations?

A. Well, we had conferences with our own staff officers on that proposition. Mr. Pulfer had succeeded Mr. Evans as the head of the sales department, and he felt that the association could operate at a profit on the loading as provided by the Investment Companies Act of 1940.

[fol. 2543] Q. Mr. Risley, isn't it a fact that early in this year, before receivership, at a conference you had with Mr. Sims and Mr. Harlan Justice, you told Mr. Sims that one of the principal troubles with the company was that they couldn't operate within their loading?

A. At that time that is absolutely correct, because we were bound by these leases for these offices, which were way beyond the means of the association, either with or without the Investment Companies Act to handle.

Q. The company never had been able to live within the loading on this contract? Isn't that true?

A. No, I wouldn't say so, Mr. Palmer. The agency division could not or did not live within their means.

Q. That is what I was speaking of in particular. The selling end of the company is what you call the agency end? Is that right?

A. That is right.

Q. The sales end had never been able to live or did not live within the loading provided for? Isn't that true?

A. I wouldn't want to go so far as to say they never had. [fol. 2544] I mean during the period while I was with them. I think that they did during that period live within their means, and of course, I don't know whether it has been brought out here in prior testimony or not, but the extravagance of the management of National Sales Agency was beyond any reason or any reasonable thought; it was beyond necessity in securing their sales force. I don't know whether that has been brought out here before or not.

Q. Well, if it has we would like to have you tell us more fully. The evidence, as I have already told you, discloses that of each dollar paid in by contract holders 18.9 cents was actually spent between 1927 and 1936 for selling. That was far and away above the loading for selling, wasn't it?

Mr. Ray: Your Honor, is this figure of 18.9 cents in evidence, that it was on every contract that this company issued, or is it—

The Court: I think Mr. Palmer is referring to a statement in a booklet which he has introduced which indicated that that was the average.

Mr. Ray: Average. Now, we have this series of contracts, and each one of them has a different loading for each [fol. 2545] one of these items, and for that reason I think this question is improper.

Mr. Jaegerman: Your Honor, those percentages were based upon the actual loading in the contract, and the percentage of that based against the amount paid in. Under the terms of the contracts, for instance, the first five or six payments might be 100 per cent loading, and that is why you get the 20 per cent in comparison with $7\frac{1}{2}$ per cent loading that the contract might set forth. Those figures were based upon the total amount that was received, being mostly the amount paid in under the first five or six installments of the contract.

The Court: I think it ought not to be stated just as Mr. Palmer stated in his question, that the evidence is that a certain amount of money was spent out of each dollar for sales expenses. That was not exactly what the testimony disclosed.

Mr. Palmer: Let me, at the expense of the Court's dislike of reading a book, read one sentence.

The Court: All right.

Mr. Palmer: "The salesmen's commissions are paid if, as and when installment payments are collected. Total commissions paid through the period 1927—1936 amounted to \$9,308,000, a sum equal to 18.9 per cent of total installment payments, i.e. 18.9 cents of every dollar paid by certificate holders was required to meet commission payments." Perhaps I made it too broad, including all selling expenses; I should have said commission payments only.

The Court: That is for those particular years.

Mr. Palmer: Yes, I limited it to that.

The Court: All right.

Mr. Palmer: Mr. Risley, forgetting the cost of selling other than commissions, it is disclosed that 18.9 cents of every dollar paid in was paid back out in commissions to

the salesmen during the period stated. Isn't that figure far and away above the loading allowed under the 1940 Investment Companies Act?

A. Yes.

Q. What is the loading allowed under that—the total loading?

(No answer.)

Mr. Palmer: Can Mr. Reinhardt give us that?

Mr. Reinhardt: Seven per cent. Section 28 (a) (2) (A) [fol. 2547] of the Investment Companies Act—

Mr. Palmer: Seven per cent for what period of time—one year?

Mr. Reinhardt: (Continuing) Provides that "aggregate reserve payments shall amount to at least 93 per centum of the aggregate gross annual payments required to be made by the holder to obtain the maturity of the certificate. The company may at its option take as loading from the gross payment or payments for a certificate year, as and when made by the certificate holder, an amount or amounts equal in the aggregate for such year to not more than the excess, if any, of the gross payment or payments required to be made by the holder for such year, over and above the percentage of the gross annual payment required herein for such year for reserve purposes."

Now, the payment required for reserve purposes is set out in the previous part 28 (a) (2) (A), and that is that the reserves may be graduated according to certificate years so that the reserve payment or payments for the first certificate year shall amount to at least 50 per cent of the required annual payment for such year and the reserve [fol. 2548] payment or payments for each of the certificate years from the second to fifth inclusive shall amount to at least 93 per cent of each such year's required gross annual payment and for the sixth and each subsequent certificate year shall amount to at least 96 per cent of each such year's required gross annual payment.

As I gather, the effect is that the loading in the first year might run as high as 50 per cent, but over the entire life of the contract it can't run over 7 per cent.

Mr. Palmer: Am I mistaken in figuring the total loading to amount to approximately \$87.00 on your \$10.00 a month contract? In other words, you can take \$60.00 out the first year?

Mr. Reinhardt: No, you take 93 per cent of the total amount paid in over all the years that the contract holder makes his payments. That has to be invested as the reserve behind the contract. Now, everything above the 93 per cent over the entire life of the payments is available for loading.

Mr. Palmer: That would leave 93 cents out of each dollar [fol. 2549] that must go into reserve?

Mr. Reinhardt: Right, and seven cents is available for loading.

The Court: In comparing the 18.9 which was used for expense during those years with the loading permitted under the new Act, an element must be taken into consideration in addition to what you have already spoken about, and that is whether or not the contracts were in their early stages or their later stages at the time.

Mr. Reinhardt: Because in the early stages under this Act up to 50 per cent is available for loading, whereas over the entire life of the payments it cannot be more than seven per cent.

The Court: That is right.

Mr. Farmer: If the Court please, I don't follow your Honor on that. This Investment Companies Act contains this plain and express proviso, that such aggregate reserve payments shall amount to at least 93 per centum of the aggregate gross annual payments required to be made by the holder to obtain the maturity of the certificate.

The Court: The gross annual payment is the total annual [fol. 2550] payments made at the end of the time. If it is \$120.00 a year the gross annual payments in ten years would be \$1200.00.

Mr. Farmer: And of that seven per cent would cover commissions to salesmen and all expenses in loading.

The Court: That is right, but it may be taken out 50 per cent the first year and only two per cent the last year.

Mr. Farmer: But they are still bound by that 93 per cent.

The Court: That is my understanding.

Mr. Farmer: The figure Mr. Palmer asked about is this, that 18.9 cents of every dollar paid in by the contract holder is paid to salesmen as commission. That didn't cover the general operating expense; that was just salesmen's commission.

The Court: But we don't know from that information whether this money was paid in on contracts in their first year or the second year or what year, and therefore that element must be brought in in order to make any comparison. That is all I am talking about.

Mr. Palmer: Your Honor, we think that this does do that, [fol. 2551] in that it takes in gross total payments over a ten year period of time.

The Court: Yes, but you have just brought out in evidence a number of times here that contracts are lapsed in large percentages, and that it is only the exception where a contract runs to maturity; only 10 per cent of them, I believe you said, run to maturity, and a very large proportion of them are lapsed in their very early stages.

Well, anyhow, it is five minutes after twelve. We will adjourn till 1:30.

(At 12:05 P. M. a recess was taken until 1:30 P. M.)

After Recess

1.30 P. M.

Mr. Palmer:

Q. Mr. Risley, under the Investment Companies Act of 1940, as very kindly explained by Mr. Reinhardt, it shows that on a contract paying in \$10 month for ten years, a total of \$1200, that the maximum loading for all purposes would be seven per cent of that, or \$84. Now, with the normal expenses that the company would have, together with salesmen's commissions and together with selling expenses other than salesmen's commissions, was it deemed [fol. 2552] possible by the company to live within that loading of \$84 on each total contract?

Mr. Ray: If it please your Honor, we object to that, because I think it is clear from the evidence that is in that the income from the loading will not be \$84 on every contract sold. For every one that lapses that proportion will be larger and there will be more money than \$84 per contract available for these expenses, and the question should be based on the total income available, not on the income which is available from a contract which is sold and which the purchaser completes the payments on.

The Court: The Court will ask the witness to take that element into consideration in answering this question.

Mr. Reinhardt: Your Honor, I would just like to say this. Mr. Ray said that on a particular contract which might have lapsed the amount of the loading might be more than \$84. I think under the Act that is not true. While the percentage of the amount paid in might be more than 18 per cent or any given percentage up to 50 in the first year, that would be a [fol. 2553] percentage of \$120 if it were a contract that called for \$120 a year.

The Court: And it takes the whole thing to make the \$84.

Mr. Reinhardt: That is right, so that in the first year there might be \$60 of the \$120 available, but over the entire life of the contract there would be \$84 available.

Mr. Palmer: Am I correct in this, that \$84 is the maximum amount of the load allowed on any contract, regardless of whether it went on two years or until completion?

Mr. Reinhardt: If the contract called for payments of \$1200 over the life of the contract, but of the \$84.00, \$60.00 might become available in the first year. \$60.00 would be 50 per cent of the first year's payments, although it would be a much smaller per cent of the aggregate payments. I thought I might have to object, and I may be able to save that objection by bringing this out. The 18.9 per cent is a percentage of all payments received by the company. That is, if in the payments received by the company, certain of them represented payments on the first year of the contract, [fol. 2554] the average of those would be 18 per cent of the amount paid in; it wouldn't necessarily be 18 per cent of the total payments made by any particular contract holder.

Mr. Palmer: But the 19 per cent approximately was the total percentage allocated to salesmen's commissions of every dollar paid in over a ten year period of a contract.

Mr. Reinhardt: That is my understanding.

The Court: But not over a ten year period of the same contract necessarily.

Mr. Palmer: Oh, no.

The Court: The contracts on which payments were made during that ten year period conceivably could all be first year contracts. Probably they were not, but if, as a matter of fact, only 10 per cent of the contracts are carried to completion, then there would be a much larger percentage of those contracts that are in their early stages than there would of contracts in their older stages.

Mr. Palmer: I think the Court is unquestionably right. My question to Mr. Risley is, if \$84 is the total amount

[fol. 2555] allowed on any contract, regardless of whether it is carried to completion or not, whether the company could live, with all its expenses, not only salesmen's commissions of 19 per cent but all its other expenses, within that loading.

The Court: I have asked him to answer that question taking into account the experience of the company with reference to lapses.

A. Taking the experience of lapses into consideration, I believe the company could operate profitably at that, but if 100 per cent of the contracts sold and issued went all the way to maturity there is a question in my mind as to whether or not the \$84 would cover all the expenses of selling and administration for a period of ten years.

Mr. Palmer:

Q. The evidence further shows, Mr. Risley, that 25 cents of each dollar paid in during that ten year period from 1927 to 1936 was spent by the company for total expenses, including salesmen's commissions. Would that be an abnormal period between 1927 and 1936?

Mr. Ray: It is not a question of whether it was an abnormal period. But it is a question of whether there [fol. 2556] were any expenditures which were larger than they should have been during that period.

The Court: I suppose this question is leading up to that.

Mr. Palmer:

Q. Would that be an average period of the company's existence?

A. I would say not.

Q. And is that based upon the fact that there was both a very high period of activity in the stock exchange and a very deep period of depression in the country?

A. That is quite true. During the boom days prior to 1929 we had a number of contract holders who would come in and discontinue their contracts because they could make more money in the stockmarket than they could on one of our contracts; and after the crash it was an emergency proposition then; they needed the money for several purposes to cover up on margin accounts or to live on, which caused our cash surrenders and discontinuances to be abnormally high.

Q. My question, which could have been stated better, was directed more at whether it was an average period in [fol. 2557] the company's existence in reference to expenses of the company.

A. And that period was from 1927 until when?

Q. 1936, inclusive.

A. I believe outside of some—you might say abnormal income tax and stamp tax cases, which involved considerable legal expense, that it was more or less a normal period.

Q. If it was necessary during that period to spend twenty-five cents of each premium dollar received by the company for total expenses, it would be obviously impossible for the company, or a new company reorganized, to live within a seven cent on each dollar total expense? Isn't that true?

Mr. Huwe: I object to that, your Honor. There are too many conjectural question involved about future management and future rates of interest and a lot of other factors.

The Court: I would permit that question to be asked and answered except for the fact that it still doesn't take into consideration the elements that we have been talking about, because it is conceivable that under the seven per cent [fol. 2558] limitation it is possible for twenty-five cents out of every dollar of the income of the company to be used and still keep within that limitation, depending altogether upon the age of the contracts that are being paid on.

Mr. Palmer: Your Honor, I can't quite follow the Court on that, as I could on the selling part, because this shows that of every dollar paid in over a ten year period, twenty-five cents went to necessary expenses of the company.

The Court: Let's suppose, Mr. Palmer, that all contracts being paid on in that ten year period were running their first year; that they always lapsed after the first year; then, even under the restrictions imposed now there might be 50 cents of each dollar used for that purpose and still not exceed the loading.

Mr. Palmer: Your Honor, the company, in that case, would, of course, not have expenses of setting up reserves, not have expenses of purchasing securities with those reserves, would not have expenses of collecting the many payments and so forth which would be deducted and taken off. In other words, if the policies only went one year, the [fol. 2559] expense of the company would be correspondingly less, so that the average of 25 cents over a ten-year

period would be a fair average of what the company needed during that period for expenses.

The Court: The setting up of reserves is not a part of expenses.

Mr. Palmer: Yes, it would be an expense to the company.

The Court: I don't so understand it.

Mr. Palmer: I understand all the fees paid to Mr. Young, all the managerial fees, are part of the expenses of the company.

The Court: Oh, yes, I thought you said setting up reserves was an expense.

Mr. Palmer: It is an expense to set them up on the books and make the required deposits in the various funds. All those require bookkeeping and a great many services in the offices. If you don't have to do that those expenses would be wiped out.

The Court: Let's let him answer the question. I think the witness is able to make those distinctions I have pointed out.

The Witness: Would you read that?

[fol. 2560] (The question was read.)

A. It would be impossible for the company to live on a total expense allowance of seven cents, but the experience with this type of business would indicate that the amount permitted for expense, even under the Investment Companies Act of 1940, would be greater than seven cents, and whether or not an old company or a newly organized company could exist would depend upon its management entirely.

Mr. Palmer: That is so far as loading goes?

A. Yes.

Q. I think you had started to tell us that one of the principal reasons the company couldn't exist under the Investment Companies Act of 1940 had to do with the amount the reserves had to be improved. Will you explain that?

A. The Investment Companies Act of 1940 required that the reserves behind or securing the contracts outstanding must be on a three per cent—or $3\frac{1}{2}$ per cent basis—and if the company was in existence with a higher rate required on its reserve improvement, that a deficiency reserve had [fol. 2561] to be created that would equalize the two funds on a $3\frac{1}{2}$ per cent basis.

Q. The Act also requires a net capital structure of \$50,000, and the evidence here discloses that as of at least June 6th, 1941, the general fund of Fidelity showed a deficit of \$2,600,000. Didn't that feature also play some part in the company being unable to comply with the Investment Companies Act of 1940?

Mr. Ray: May it please your Honor, we object to that because those are market values, and they are not the convention values which are used in valuing life insurance company holdings and annuity company holdings.

The Court: Overruled.

A. If that is the valuation as of June 6th, of course I was not with the company at that time.

Mr. Palmer: That is correct.

A. Not actively; and if that is the correct figures and showed a deficit of \$2,000,000, why, of course, that was another reason that the company could not comply.

Mr. Huwe: Your Honor, I move that the question and answer be stricken on the ground that the question is directed at the feasibility of a reorganization, if not good faith, and on either basis the question of whether they can [fol. 2562] raise \$50,000 for reorganization is not taken into consideration, the question of modifying any contract is not taken into consideration, nor is any other feature of the reorganization plan taken into consideration. Before a proper question can be raised as to the feasibility of a reorganization plan or the good faith with reference to a plan, those factors must be put to the witness, and then his answer must be made in the light of such factors. That question and that answer did not include those features.

The Court: As I understood, this question was simply whether or not lack of capital, in view of the deficit, was one of the elements that made it impossible for the company to comply with SEC requirements prior to any receivership or reorganization proceedings.

Mr. Palmer: That is correct, your Honor.

Mr. Huwe: But, after all, the questions relate to the two fundamental questions, and if that question as to whether or not they could comply with the SEC requirements does not bear on the two fundamental questions, it still is not relevant.

The Court: I am not sure that it does have a bearing, [fols. 2563-2568] but we have admitted quite a bit of evidence on that, so I will let it in over your objection.

Mr. Palmer:

Q. Mr. Risley, it is true, is it not, that before you left the company you knew and the company knew that the general fund, which was the capital structure fund of the company, was seriously impaired?

A. If valued on a market basis.

Q. Yes.

A. That is right.

[fol. 2569] Q. When did you first meet Mr. Messick?

A. I would say it was probably in March prior to the voting trust arrangement and the Rosset and Messick agreement.

Q. Who was it that made or arranged the contract between him and Fidelity? In other words, how did Mr. [fol. 2570] Messick come into the picture and offer the \$500,000, and who was the person he contacted to talk about it and who formed the foundation upon which the written contract was later made?

A. Mr. Pulfer.

Q. Did he conduct all those negotiations or did later anyone else come into the picture?

A. He just conducted the preliminary negotiations, and then the matter was brought to the attention of the folks in Wheeling, and then we went to Chicago, is where I met him—

Q. Who is we? Was Mr. Marshall with you on that?

A. No. No, Mr. Koontz and Mr. Foulk. We made several trips to Chicago.

Q. And was there finally a contract arranged?

A. There was.

Q. Tell the Court how this voting trust agreement came into existence—the grounds behind it, not the actual existence of it. We know it; it is here.

A. Well, in order to give control to the—what we termed the incoming money, it was necessary to create a voting trust which would guarantee fulfillment of that contract.

[fol. 2571] Q. Without going into the exact details, was this the situation, that Mr. Messick wanted to deal with one

person who would be authorized to deal in behalf of the company? Did that play any part in it?

Mr. Ray: May it please your Honor, wouldn't the contract speak for that?

The Court: I don't know that the contract would have anything to say about that.

A. Well, considerable thought was given as to the best means of arranging that power, and it was deemed best to have it in one individual.

Q. And that one individual then having the majority control of the stock of Fidelity in his hands, if the agreement were carried through, would then be permitted to transfer that majority control to the new capital or Mr. Messick and his associates? Was that in substance and in layman's language the idea of it?

A. I think that is a correct statement.

Q. And was the voting trust entered into for any other purpose than to carry through this contract with Mr. Messick if that could be done?

A. I don't know.

[fol. 2572] Mr. Ray: Your Honor, I know that is objectionable. The voting trust certainly is the best evidence as to the purposes of it.

The Court: Overruled.

—What did you say?

A. I believe not.

Mr. Palmer:

Q. Mr. Risley, when did Mr. Messick come in as chairman of the board?

A. I believe in the month of May.

Q. Of what year?

A. 1940.

Q. All right. Do you know how that happened to come about, that he became chairman of the board?

A. Mr. Pulfer reported to the directors that Mr. Messick had been offered other connections, and he felt that the company needed his services in completing this new capital procurement, and it was considered by the entire board of directors, who at that time believed that that was the proper thing to do, to retain Mr. Messick, and they elected him chairman of the board.

Q. Isn't it true that Mr. Messick, although he was one of the contracting parties to furnish this \$500,000, was not [fol. 2573] going to furnish it himself, but that he was more or less a broker or go between between the company and the person or persons who would furnish that capital?

A. Well, that I don't know.

Q. When did Mr. Fleming first come into the picture, so far as you know?

A. The first that I heard of Mr. Fleming was some time during the month of June. I heard that he had attended the directors' meeting at Pittsburgh on June 3rd.

Q. That is the first time you ever saw him in the picture?

A. It is the first time I ever heard of the man.

Q. Did you know a Mr. Weaver?

A. The attorney from Chicago?

Q. Yes.

A. Yes.

Q. What part did he have in the transformation or trying to transform Fidelity from a face amount securities company into an insurance company?

A. He having had considerable experience in the life insurance field, he was engaged sometime during 1940, probably in the early summer, to assist in preparing the [fol. 2574] life insurance policies and the rate book and all the paraphernalia that goes with a life insurance company.

Q. Who was the person or persons who brought him into the Fidelity picture?

A. Mr. Messick introduced him to us.

Q. State whether or not Mr. Weaver, if you know, prepared a booklet or brief in which he proved, or attempted to prove, that Fidelity was already an insurance company prior to January 1, 1940?

A. I have heard him say that, but I have never seen any written evidence—anything that he has prepared in writing.

Q. For how long a period of time prior to the actual change of charter of Fidelity from its former name to its present name was the idea of Fidelity as an insurance company discussed or talked about by the officials of the company, including the board of directors?

The Court: You mean the idea of changing it from what it was to an insurance company?

Mr. Palmer: Yes, your Honor.

The Court: All right.

A. I would say about five or six months prior to the [fol. 2575] actual change.

Mr. Palmer:

Q. State whether or not that was discussed at the board of directors' meetings.

A. It was.

Q. Was it discussed with Mr. John Marshall, the general counsel?

A. Yes, sir.

Q. Am I correct in stating that Mr. Tom Foulk was your local attorney and that Mr. John Marshall was your general counsel?

A. That is right. Mr. Foulk's title was general attorney, and Mr. Marshall's general counsel.

Q. Was that idea discussed with both of them?

A. Yes.

Q. And was it also discussed with the firm of Koontz & Koontz?

A. It was.

Q. And I understand you to say Mr. Weaver, an attorney of Chicago?

A. Yes, he is at the present time.

Q. Was it the intention of the company to determine if something couldn't be done to save the company by virtue [fol. 2576] of turning it into an insurance company? Is that correct?

A. Well, the idea was that the insurance field offered broader opportunities for profit. At least, that was the way we felt about it.

Q. How long prior to January 1, 1941, was it that the officials of the company and the board of directors knew that something would have to be done in order to preserve the company as a going concern? How soon did they first start discussing that? Was that at the same time they started discussing an insurance company or before or later?

A. As I recall now, we first started, I would say, to try and conform with the Investment Companies Act of 1940 by preparing a new form of contract, and it was some time after that that the insurance idea took form.

Q. In other words, I gather from your statement that when the Investment Companies Act of 1940, either before or at the time of its passage, was brought to the attention of the officials, they knew that something would have to be done to change the then form of Fidelity? Is that correct? [fol. 2577] A. That is right.

Q. And that the first thing that was thought of was to try to develop a new form of annuity contract?

A. That is right.

Q. And that idea was abandoned and the idea of an insurance company began to be talked about?

A. That is right.

Q. And the company went so far, did it not, as to change its charter to a life insurance company?

A. That is correct.

Q. And it changed its preferred stock to common stock, in order to comply with the insurance laws, which permit only one class of stock? Isn't that true?

A. That is right.

Q. And isn't it further true that the company took out an insurance license, although no business was ever done under it?

A. That is right.

(There was a discussion off the record.)

Mr. Palmer: I will make the following offer into the record. I offer to prove by this witness, if permitted, that in the early part of 1938 Mr. Jaegerman, Mr. Chapman, and [fol. 2578] other gentlemen from the Securities and Exchange Commission came to the home office of Fidelity Investment Association for the purpose of investigating the company and spent a number of months there; that Mr. Arthur Koontz, at the request of the board of directors, got in touch with Mr. Lane, general counsel of the Securities and Exchange Commission, and asked that if it be discovered that Fidelity was doing anything that, in the opinion of the Securities and Exchange Commission, was improper, that Fidelity be notified and a conference had to see if that matter could not be corrected; that in December of 1939, Mr. Koontz being in Washington, was notified by Mr. Lane, upon an inquiry, that there had been very serious matters discovered in the investigation, and thereupon called Mr. Risley and Mr. Tom Foulk to come to Washing-

ton; that upon arriving in Washington they called Mr. Lane, and he informed them that they could not have a conference with the Securities and Exchange Commission concerning the practices, because a suit would be filed that day; that they were not advised as to where it would be filed; that newspaper reporters informed them it was filed [fol. 2579] in Detroit, and that the Securities and Exchange Commission handed out news releases to the newspapers which were widely printed and which news releases had been prepared by the Securities and Exchange Commission or their employees, which news releases were extremely unfavorable to Fidelity and which seriously affected the sales of their securities after that time. That is the offer to prove.

Mr. Reinhardt: I feel called upon to say now, your Honor, that I don't know what the facts are as to this of my own knowledge, and as to most of it I do not even have any information, but I do not want it to be taken that I am admitting that this evidence would be uncontradicted or that it represents the facts.

Mr. Palmer: Well, Mr. Jaegerman is here present and can answer whether those facts are correctly stated.

Mr. Reinhardt: I have consulted Mr. Jaegerman about that. He says he has no personal knowledge of all of those facts.

Mr. Palmer:

Q. You say that you were in Washington when news of the SEC suit in Detroit reached you? Is that correct? [fol. 2580] A. That is correct, yes, sir.

Q. I would like you to tell the Court how Mr. Koontz came to be then employed to take charge of the defense of that suit or the negotiations of the SEC about it, and whether it was a desire upon his part to be employed or the contrary.

A. Purely by coincidence the investment committee had scheduled a meeting in Washington that same morning, and the president of the company was there—

Q. Who was that at that time?

A. Colonel Thompson. Mr. Sutherland, Mr. Walter Grosscup, Mr. John Marshall, Jr. Mr. Koontz was a member of the committee at that time, and Mr. Foulk and myself of course were there for the purpose of the conference

with Mr. Lane, and the committee immediately went into session, and as they constitute a majority of the board of directors they took it upon themselves at that time to request Mr. Koontz to handle our case for us. He advised us that he had been offered another assignment which would take him to the Pacific coast.

Q. Did he say who that was?

Mr. Huwe: I object.

[fol. 2581] The Court: Overruled.

A. Mr. Giannini.

Mr. Palmer:

Q. Of what company?

A. Of the Bank of California or—

Q. Would it be Bancamerica?

A. Bancamerica, I guess—which would mean considerable money to him, but finally he agreed to represent us and did not accept the California assignment.

Mr. Huwe: Your Honor, I move that all of the last answer be stricken from the record on the ground that it in no way shows that Mr. Thomas was concerned with that particular procedure. The only reason we are bringing in the Koontz & Koontz work in this proceeding is where it has a tendency to show Mr. Thomas's ability as a state receiver. None of that question or answer shows in any way Mr. Thomas's specific connection with that proceeding.

The Court: Overruled.

Mr. Palmer:

Q. And state whether or not the board of directors and the committee then present had to use some persuasion to get Mr. Koontz to take the assignment of the defense of that case.

A. I would say that they did.

[fol. 2582] Q. Now, leaving that, I will ask you if you know Mr. John Marshall, Jr.?

A. I do.

Q. And I will ask you if you know that after graduating from Yale University he was employed for approximately a year by a prominent New York brokerage or banking house?

A. I understand that he was, yes, sir.

Q. And did you know that following that he then became general sales agent of Fidelity in the Baltimore district?

A. I think that you will find that he first became a salesman in the Washington office and then subsequently was given the Baltimore assignment.

Q. And how long was he connected with the sales end in the field for Fidelity before he came to the home office?

A. In my best judgment about two years.

Q. About what?

A. About two years.

Q. When he was brought to the home office what was the title given to him?

[fol. 2583] A. Vice president.

Q. State whether or not he was put upon the board of directors.

A. He was.

Mr. Ray: Your Honor, may we inquire what the pertinency of this is, or the relevancy of it?

Mr. Palmer: Yes, I will be glad to show you in just a few minutes with a question.

Q. What age was Mr. Marshall, Jr., at that time, approximately?

A. I would say around twenty-eight or thirty.

Q. State, if you know, whether he was brought to the home office and made a vice president and director at the request and through the influence of his father, John Marshall, Sr.

A. I have been so informed.

Q. State, if you know, if this, in all fairness to Mr. Marshall, Jr., was done without his, John Marshall, Jr.'s knowledge?

A. I believe that it was.

Mr. Palmer: Now, your Honor, the purpose, I believe, is obvious, in showing the activities of Mr. John Marshall, [fol. 2584] Senior in the company and his influence in the company. That is the purpose of it, and nothing else.

Mr. Ray: I move that it be stricken from the record, your Honor. It has no relevancy to any issue involved in this proceeding.

The Court: Well, I am going to leave it in. However, it seems to me there has been no denial anywhere of what you say you are trying to prove, namely, that Mr. Mar-

shall was influential in the company and a large stockholder and had a good deal to do with it.

Mr. Palmer: I understood from Mr. Marshall's own testimony that he had denied that, had denied taking an active part in the company.

(There was a discussion off the record.)

Mr. Palmer:

Q. Mr. Risley, Fidelity actually was changed—the charter was changed—to an insurance company in December, 1940. Is that correct?

A. December 31, I believe.

Q. State whether or not thereafter numerous conferences were had among the directors as to what to do in order to get the company operating as a going concern again.

[fol. 2585] A. There were many conferences.

Q. State whether or not you spent some time in Charleston at the office of Koontz & Koontz.

A. I did.

Q. About how long a time were you there, not continuously but from time to time.

A. I spent from one to four days continuously at different periods up until April.

Q. Did you also confer with Mr. Marshall and other members of the board of directors and Mr. Foulk, the general attorney?

A. Mr. Foulk daily and Mr. Marshall occasionally.

Q. And was everything attempted that could lawfully and reasonably be attempted to begin the company's operations as an insurance company?

A. I believe so.

Q. Were there a number of plans prepared by Mr. Latta, the actuary of your company?

A. There were no completed plans up until the time that I left.

Q. No, I meant tentative plans, hoping to arrive at something that could be definitely worked out.

[fol. 2586] A. Oh, yes. There were several ideas advanced by Mr. Latta.

Q. And those were put into—I will call it a rough-draft form—typewritten up and in shape so that you could work on them and see what could be done with them?

A. Not while I was there.

Q. State whether or not you had conferences with Mr. Sims, the State Auditor, during this period.

A. I did.

Q. Did you have conferences with Mr. Messick during this period?

A. Yes.

Q. Now I wish you would advise the Court what, if any, efforts were made over the last two or three years since the SEC suit of 1938 by yourself, by Mr. Koontz or others, to attempt to attract new capital into the company, other than the Mr. Messick deal, of which we know.

A. That was almost a continuing operation from one group to another, from as far as Cleveland and New York and Philadelphia.

Q. Did Mr. Koontz have a discussion and prepare figures [fol. 2587] and present to Pell, Ltd., of New York, if you know?

A. I believe that Mr. Young presented figures to them upon the request of Mr. Koontz.

Q. State whether or not Mr. Grosscup had some people in Philadelphia that he tried to interest?

A. He did.

Q. Who were the people in Cleveland, if you know, that were attempted to be interested?

A. I believe it was Otis and Company.

Q. Can you tell us whether Mr. Messick attempted to get people in Chicago and that vicinity interested?

A. He has said that he did.

Q. So that there was a continual effort to attempt to re-finance Fidelity?

A. Yes.

Q. And did that refinancing include the idea that it would be reorganized as part of the development or putting new capital into it?

A. Some of the plans contemplated that; others just contemplated the issuance of additional capital.

The Court: Let me ask you this, Mr. Risley. In these [fol. 2588] efforts of Mr. Koontz to procure new capital, what representations did Mr. Koontz make as to whether or not the company was in a sound condition and whether or not there was a reasonable prospect for it to continue in business if new capital were put in, and other representations of a like kind, if you know?

A. To my own knowledge, I know that the audit reports made by the Certified Public Accountants were furnished to these people for study, which included Mr. Morris of the Morris Plan Bank, Mr. Floyd Odium, and Otis and Company—I think their office is in Cleveland—and Mr. Young supplemented that with an analysis of the securities portfolio.

Q. But that is not my question. I want to know what representations Mr. Koontz made along that line.

A. Well, I couldn't tell you that.

Q. Well, I thought you said that you knew he was trying to get new capital.

A. He was, but as to what statements he made to these people, I don't know, because I was not present.

The Court: All right.

Mr. Palmer:

Q. You do know that at his request the certified accounts [fol. 2589] of the company were sent to these people for their investigation and study?

A. Yes, sir.

Q. And you do know that Mr. Koontz happened to be acquainted with or to become acquainted with a number of highly reputable financial people whom he hoped or the company hoped might invest in the company?

A. That is correct.

Q. That covered a period of time from when to when?

A. Immediately following the conclusion of the bankruptcy case in Wheeling right on down to the adoption of the insurance plan.

Q. One other thing, Mr. Risley. You naturally have had access to all the books of the company, have you not?

A. Yes, sir.

Q. And as a director you have access to the minutes of the board of directors, I believe? Is that correct?

A. That is correct.

Q. And isn't it true that you know generally, without specifically mentioning any one amount, the fees generally that have been paid to Mr. Arthur Koontz or to his firm? [fol. 2590]

A. In a general way, yes, sir.

Q. Will you tell us how those fees were investigated, if they were, by the company, to what committee or commit-

tees or attorneys they were referred, before action was taken on paying them?

A. Well, since about 1926 or 1927 the attorney bills—the bills for attorneys' fees were submitted to the general counsel.

Q. That is Mr. John Marshall?

A. (continuing) For his recommendation, and in case of extraordinary fees sometimes a committee was appointed from the board of directors to give it study.

Q. And do you know if that was done in the case of all the fees submitted by Mr. Arthur Koontz or his firm?

A. All the fees paid to Mr. Koontz were approved by the general counsel, and in some instances a committee passed on them.

Q. That was the fees in the larger amounts?

A. Yes, sir.

Q. Do you know whether or not, without asking your knowledge of law or legal fees, work was performed for [fol. 2591] every fee that was paid to Mr. Arthur Koontz or his firm?

A. Work was performed by every attorney that ever received a fee from the association while I was connected with it.

Q. And in all of the cases and fees paid to any attorney, in your opinion, were the services performed such as to warrant the amount paid them as fees?

A. In some cases I felt that probably the fees were high.

Q. And in those cases did you object to the payment?

A. We did. And in some cases we got reductions.

Q. Did that ever apply to any of Mr. Arthur Koontz's fees?

A. Not that I know of.

Q. There was never any objection raised by anyone as to their amount, to your knowledge?

A. Not to my knowledge, no.

Q. From the first of January of this year on until—

The Court: Just a minute before you start that, Mr. Palmer.

Q. Did you have any knowledge of Auditor Sims' objection [fol. 2592] to the fees paid Koontz & Koontz?

A. No, I did not.

The Court: All right. Go ahead.

Mr. Palmer:

Q. Mr. Risley, from the first of January, 1941, until the state receivership proceedings were instituted, were you, together with others of the company, doing everything possible to get operating again and selling?

A. We were.

Q. And there was a letter introduced here in evidence, or a copy of a letter, addressed to Mr. Koontz by Mr. Sims, which stated in substance—dated March 25, 1941—which stated in substance—perhaps I had better get the exact letter. I will hand you Exhibit No. 94 and ask you to read it.

(Witness examines paper.)

A. Yes, sir.

Q. Did you see the original letter sent by Mr. Sims, or were you informed of the contents of it?

A. I believe I have seen that letter before.

Q. That letter states that Mr. Sims was intending to bring a state court proceeding, but also suggests that the [fol. 2593] company investigate the possibility of a federal proceeding for reorganization, Mr. Sims calls it under 77B. State whether or not, regardless of whether you saw that letter or anyone else did, there was a discussion among the officials of the company as to whether state or federal proceedings would be for the best interests of the company, that is, proceedings for reorganization.

A. There was.

Q. Did Mr. John Marshall and others partake in that discussion of the full board of directors or the board of directors that was in there?

A. They did.

Q. Do you recall whether or not Mr. Koontz brought this letter, or the substance of it, to their attention?

A. He did.

Q. Was there a conference had with the Securities and Exchange Commission as to whether state proceedings or federal proceedings would be for the best interest of the company, or at which that was discussed?

A. There was a conference relative to a plan that we had for revaluing—a plan that we had for revaluing the present outstanding contracts, and that was held in Wash-[fol. 2594] ington on April 1st.

Q. Of what year?

A. 1941.

Q. Who was present at that conference?

A. It was a very large conference. It was Auditor Sims, Mr. Justice, Mr. Koontz, Mr. Jaegerman, Mr. Jackson, Mr. Smith, their accountant, Mr. Lane, Mr. Klein, Mr. Schencker, Mr. Pulfer.

Q. Was Mr. John Marshall present?

A. No, sir.

Q. Was Mr. Messick present?

A. I think not.

Q. Was Mr. Tom Foulk present?

A. I don't recall him being there.

Q. State whether or not at that conference the matter of whether a proceedings in state court or federal court would be to the best advantage of Fidelity was discussed.

A. I doubt that it was discussed in the open session when all those people were there. I think it was discussed later on in the afternoon.

Q. With whom?

[fol. 2595] A. I think principally with Mr. Klein and Mr. Lane. That is a little bit hazy in my mind.

Q. State whether or not it is not a fact that the Securities and Exchange Commission said that they would not advise the company as to whether state court proceedings or federal court proceedings would be for its best interest.

A. They wouldn't make any recommendation which way to go.

Q. After that state whether or not the results of that meeting were reported to the board of directors and fully discussed by the board of directors of Fidelity as to whether state court proceedings or Federal court proceedings would be for the best interests of Fidelity.

A. Yes, sir, that was presented to the board of directors within a very few days after our meeting in Washington.

Q. Was Mr. John Marshall present at that meeting?

A. He was.

Q. And was Mr. Messick present at that meeting?

A. I am quite sure that he was.

Mr. Warner: If your Honor please, we object to this [fol. 2596] line of questioning on the ground that whatever was said there is not binding on creditors of the company.

The Court: Overruled.

Mr. Palmer:

Q. And isn't it a fact that at that meeting of the board of directors a thorough discussion was had by the directors of the company concerning the situation of Fidelity, that they had knowledge of the fact that proceedings of some sort were necessary to protect the assets until some plan or some reorganization could take effect, and that after fully exploring the possibilities of state and federal court it was determined that they favored a proceeding in state court?

A. That is correct.

Q. And wasn't that a unanimous decision at the end of that conference?

A. Yes, sir.

Q. And isn't it further a fact that at that—I call it conference—a board of directors' meeting—there was then passed a resolution of the board of directors employing Koontz & Koontz and Mr. Tom Foulk to represent the debtor's interest in filing an answer to a proceedings to be brought?

[fol. 2597] A. That is correct.

Q. Isn't it further a fact that Mr. John Marshall employed Mr. Robert Riley, of the City of Wheeling, to help him and Mr. Messick and others in connection with this matter?

A. I believe that he did.

Q. When was this directors' meeting, as you recall it.

A. Around the 6th, 7th or 8th of April—sometime right along in there.

Mr. Huwe: What month?

A. April.

Mr. Palmer:

Q. After the state court proceedings were brought, Mr. Risley, when was the first time anyone ever informed you that there was to be a proceeding brought in federal court?

A. The first I heard of it was when I had a report of what occurred at the meeting in Pittsburgh on June 3rd.

Q. Were you notified of that meeting in advance?

A. I was.

Q. Who notified you?

A. I don't recall who signed the notice to that meeting.
[fol. 2598] I believe it was Mr. McNulty, the secretary.

Q. I may be mistaken—if I am, I trust that some of counsel will correct me—that Mr. Marshall testified that he personally notified you of the meeting and asked you to be present. If I am mistaken, I wish some of counsel or the Court would correct me. That is only my recollection.

Mr. Ray: That doesn't exclude the fact that he was given the proper written notice of the meeting.

Mr. Palmer: I agree with that, Mr. Ray.

The Witness: But I do not recall who signed it.

Mr. Palmer:

Q. Let me ask you, did Mr. John Marshall, Sr. contact you before that meeting by telephone or personally or otherwise before it took place?

A. No, the only notice that I had was this letter. If he signed it, then he did have contact with me, but otherwise not.

Q. Did anyone tell you, Mr. John Marshall, Mr. Fleming or Mr. Messick or anyone else, that at that meeting there would be taken up a resolution or a discussion even that this proceeding should be brought in federal court instead [fol. 2599] of letting the proceedings go along in state court?

A. No.

Q. You had no notice of that before that meeting at any time? Is that correct?

A. That is right.

The Court: Mr. Palmer, do the by-laws require that notices of directors' meetings state the purpose of the meeting?

Mr. Ray: I think it does at a special one. I think this particular notice does. That is what I was looking for, if you will give me a moment.

Mr. Palmer: I can't give the answer.

The Court: Then go ahead.

Mr. Palmer: If your Honor please, I believe that Mr. Pulfer promised us that he would send here the notice that he had received of that special meeting of June 3rd. It is not incorporated in the board of directors' minutes, and if I am not mistaken there has not been any copy produced by anyone of the written notice of that meeting. Mr. Pulfer promised that he would mail it immediately

upon his return and we have not heard from it yet. I [fol. 2600] wonder if someone can give us information about it. Mr. Ray, he was produced as a witness for the debtor. Can you give us any information concerning it?

The Court: I understand Mr. Ray is looking to see if he can find the notice now.

Mr. Palmer: Oh! good!

Mr. Ray: I have seen a copy of it, your Honor; I am just trying to find it.

Mr. Palmer: Well, take your time. I will go on with my other subject.

Q. After the state court proceeding was brought, Mr. Risley, were you kept on as an employee of the state court receivers?

A. For about eighteen days.

Q. How long, if you know, was Mr. John Marshall, Sr. and how long was Mr. John Marshall, Jr. kept on as employees?

A. That I don't know.

Q. Beg pardon?

A. That I do not know.

Q. Now, Mr. Risley, with reference to this particular company, isn't it true that you testified in Washington, [fol. 2601] D. C., before the Securities and Exchange Commission on January 28, 1938?

A. Yes, sir.

Q. At that time is it not true that the Securities and Exchange Commission had a large amount of data concerning Fidelity and had many charts and tables prepared by their experts for use in that hearing?

A. They had detailed information of eleven years of the company's operation.

Q. And did they have that presented and prepared in the way of charts so it could be easily studied and examined?

A. I don't believe they had any charts. I never saw any.

Q. Isn't it a fact that at that hearing you were asked if approximately 5.29 per cent of all contracts went to maturity, and that you stated you thought that figure was too low? Do you recall that?

A. I can't say that I do. I know that questions were asked concerning the maturity experience. If that is a copy of my testimony why that is—

Q. Well, isn't it true that at that time and since you [fol. 2602] felt that probably 10 per cent of those who invested carried their contracts through to maturity?

A. I would say at least 10 per cent would.

Mr. Ray: Your Honor, what I have is one of these copies of a copy. It is a copy made from the notice which Mr. Reed had. It is Mr. Reed's copy, and this was prepared and put in the minute book, and then, because it was addressed to Mr. Reed, it was not inserted in the minute book. If Mr. Palmer wants to ask the witness if he got a notice similar to that, I think it might be made admissible. It certainly is not now.

Mr. Palmer:

Q. I will ask you to read that and state if it is similar to a copy of the notice that you received of the board of directors' meeting?

A. I believe that mine was similar to that one.

Mr. Palmer: We have no objection to it being a copy of a copy, your Honor.

The Court: Let me take a look at it.

Mr. Palmer: Surely. (Handing paper to court.)

Mr. Ray: Your Honor, I think it should be put in the minute books or attached to the certificate of the man who mailed the notices, where it was originally intended [fol. 2603] to be put. I didn't think it was quite proper, and I didn't put it in.

Mr. Palmer: May I suggest it might be a good idea at your board of directors' meeting tomorrow to take that up and by some official action have it put in the book, rather than for us to put it in in a court proceeding.

Mr. Ray: May we mark it for identification?

Mr. Palmer: All right. Mark it as an exhibit rather than for identification.

Exhibit 96.

The paper referred to was admitted in evidence, marked as above indicated, and the same is attached hereto as a part hereof.

Mr. Palmer:

Q. There has been a number of plans of reorganization thought of and proposed and attempted long prior to this meeting, isn't that correct?

A. Several plans, yes.

The Court: Prior to what meeting?

Mr. Palmer: Of June 3rd.

The Court:

Q. You mean there were different plans discussed between the meeting of April 7th and the meeting of June 3rd? [fol. 2604] **A.** I couldn't say to that, because I was not there.

Q. Well, the plans you have reference to that were discussed were discussed before the meeting at which the decision was made to have the Auditor bring a suit in the Circuit Court of Kanawha County?

A. And then they were discussed after the suit was filed in Kanawha County, and I participated in those discussions up until the 28th of April.

Q. Do you mean that there were discussions among the board of directors as to plans that the company would undertake for reorganization, or were those plans of the receivers?

A. They were just general plans of what would be fair and feasible to the contract holders in making any adjustment, which was the main topic of discussion at the conference with the SEC on April 1st and 2nd.

Q. What the Court is trying to get at is this. Was there any discussion that would look towards action of the company through its board of directors on some different plan of reorganization than the one started in the state court?

[fol. 2605] **A.** No, not after the case was filed in Kanawha County.

Mr. Palmer: I don't want to correct the Court, but the Court used language to the effect that it was decided to have Mr. Sims bring a suit in Kanawha County. I believe in the letter of Mr. Sims he said he was going to do it.

The Court: All right, submit to it, then, instead of having him do it.

Mr. Palmer: Isn't this true, Mr. Risley, that the company recognized that something must be done, and that they were not objecting to some sort of proceedings brought in order that the assets might be held in statu quo while the company could arrive at some reorganization plan?

A. That was the sole purpose.

Q. And that, that is why there was no objection on the company's part to Mr. Sims suit? Isn't that correct?

A. That is correct, yes, sir.

Q. The company knew that there had to be something done, otherwise there might be a run on the company by cash surrenders which would give those who got there first their money and those who came last would not get [fol. 2606] any?

A. That is correct.

Q. So that the company had, through its officials, after this letter of Mr. Sims as well as before, discussed with Mr. Sims the possibility or need of such a suit, and also had discussed the possibility or need of a federal court suit? Isn't that right?

A. That is right.

Q. And it was only after a thorough discussion and weighing of all matters that the company decided that it preferred, if it had a choice, the state court proceeding?

A. After weighing the matter it was the unanimous opinion of the board of directors that the state court method would be the best.

Q. And isn't it further true that not only the sentiment, or the expressed sentiment, of the board of directors was that that state court proceeding would lead to a reorganization of the company rather than a liquidation of it?

A. Reorganization was the only thing that we were considering.

[fol. 2607] Q. There was no thought of any kind, either by Mr. Sims, by the SEC or by the company, of a liquidation, but only a thought of some sort of reorganization? Isn't that true?

A. Reorganization is the only word that I heard mentioned in any of those conferences.

The Court:

Q. Mr. Risley, how many of the men that you say were unanimously in favor of a state court proceeding were the same men who later held the meeting of June 3rd?

A. Well, if I have been correctly informed, it would be six.

Mr. Palmer: If your Honor please, might the board of directors' meeting of April 7, 1941, be read to show who

was there, so that Mr. Risley might answer your question in the light of that?

The Court: Yes, go ahead.

Mr. Palmer: Reading from the minutes of the board of directors, "Quorum present, Chairman Messick presiding. Present: Messrs. F. S. Risley, F. H. Pulfer, John Marshall, Sr., John Marshall, Jr., H. E. Reed, D. A. Burt, A. L. King [fol. 2608] and Tom B. Foulk; Mr. R. A. Latta, actuary, present by invitation."

The Court: What I want to know is how many of these men changed their minds between that meeting and the meeting of June 3rd.

A. Well, as I said before, there would be six, if my information is correct, was the the number of directors that attended the meeting in Pittsburgh on June 3rd. I understand that Mr. Burt was not present, and I was not present.

Q. Mr. Burt has testified here that he changed his mind.

A. I see. I didn't know.

Q. And Mr. King has testified that if he had known of certain facts that he would probably have changed his mind also. Now, that leaves only you, then, that did not change your mind.

A. I didn't know anything about it.

Q. How about Mr. Foulk? Was he present at the June 3rd meeting?

A. No, I think he had resigned prior to that meeting.

Q. You don't know what his attitude was on June 3rd?

A. No.

[fol. 2609] Mr. Palmer: I am sorry, your Honor; I was reading these minutes. What was it the Court said with reference to Mr. A. L. King changing his mind?

The Court: I said he testified that had he been acquainted with certain facts he probably would have changed his mind as to the desirability of federal rather than state reorganization. I believe I am correct in that.

Mr. Howe: That is right, your Honor. I asked him that question.

Mr. Palmer: I will ask to introduce in evidence the board of director's meeting of April 7th, 1941, as shown on page 173 of the minute book.

(The minutes referred to were read by Mr. Palmer.)

The Court: I understood this witness to say and to testify from the proceedings of the company that there was a unanimous decision at that meeting of April 7th that the directors preferred reorganization in the state court rather than reorganization under Chapter 10 in the federal court. On reading these minutes I see no mention of that. What is the explanation?

Mr. Palmer: I don't know, your Honor. Are you pre-[fol. 2610] senting the question to me or to Mr. Risley?

The Court: To you.

Mr. Palmer: I don't have any idea. And I know nothing about that. Perhaps Mr. Risley can tell us whether it was discussed and the minutes not taken down, or what the situation was.

The Court:

Q. Did you mean, Mr. Risley, simply that there was a unanimous vote on the resolutions that are in the book?

A. That is correct, and likewise it was the unanimous opinion of all the directors present that the proceedings about to be instituted by Mr. Sims was the best plan.

Q. I asked you something a while ago that may have included an assumption. I asked you if you were the only person, with the possible exception of Mr. Foulk who didn't change his mind about that between the 7th of April and the 3rd of June. I don't know whether you changed your mind or not, did you?

A. I had not been given any information relative to this proposed change and knew nothing about what caused it or why until I arrived here in Charleston last night. I have [fol. 2611] not been kept informed of the affairs of the association since I left.

Q. Can you say now whether, had you been present at the meeting of June 3rd, 1941, you would have voted for the filing of the petition under Chapter 10, or would you have voted against it? Could you say that now?

A. I don't believe, your Honor, that I have had sufficient information yet to make up my mind which way I would vote.

[fol. 2612] J. H. SCHELLHASE recalled, testified as follows:

[fol. 2613] Cross-examination.

By Mr. Farmer:

Q. Mr. Schellhase, since you testified here last have you done some more figuring on this estimate of the income of the company and expenses?

A. Yes, I have.

Q. Will you just tell us what you have figured on it and how you figured it out?

A. I have made a more up-to-date schedule on that. Those figures were taken as of October 31, 1940. I have prepared or taken from the records the income and expense for the first five months and six days of 1941, or up until the time the trustee was appointed. Then I have estimated the income and expense for the next seven months, so that in my figures there is actual figures for the first five months and six days and an estimation for seven months. The six days in between there didn't amount to much, because all of the income comes in or is credited around the end of the month, so the first six days there is not much difference in there. So that for the year 1941, if improvements were allowed to go on or to be put on the reserve funds for the [fol. 2614] entire year,—of course they were for the first five months, or up until April 10th, rather—but if they were to go on for a whole year the loss would be \$453,847.92; but in that figure there are security losses of \$275,000 approximately, which are chargeable against principal and not against income, since the value of the securities were set at April 10th, the market values of them, any security losses would be charged against the principal instead of against the income of those securities.

The Court: Losses on account of decrease in market value?

A. Yes, sir, any sales that were made, your Honor, in between that time.

Mr. Ray: State what the loss was in this case.

A. It was losses on stocks held as collateral on a bank loan over in the Continental Illinois Bank in Chicago—had to be sold to pay off the loan.

Mr. Farmer:

Q. Were they sold?

A. They were sold.

Q. That was after April 10th?

A. Yes.

Q. Was that loss the difference between the amount [fol. 2615] realized and the book value?

A. That is right.

Q. The book value and not the market value?

A. That is right. They secured so much for them, and the book value was so much, which resulted in a loss of approximately \$300,000.

Q. You said \$250,000.

A. I said \$275,000, but I have taken off of that figure a little gains that were made on sales, so the approximately loss was \$275,000, which was eliminated from your \$293,000 loss and would give you a loss of \$878,823.24, which I have figured, and have estimated the expenses for the last seven months to be \$90,000 and the expenses for the first five months were \$164,000, \$254,200.29 of expense, which, if eliminated from your loss of \$178,000, would leave you a balance for the year 1941 of \$75,977.05.

The Court: For the whole year, or for the seven months?

A. It would leave that for the whole year, your Honor. That is taking the actual five that has already gone and estimating seven months. Now, if no improvement was [fol. 2616] made to the reserves after April 10th, and we used the actual figures for the first five months and the estimation for the seven months, leaving out the improvement that was estimated for the seven months that has not been put on the reserves, we would have a profit of \$249,524.06, of which security losses of \$275,000 is included in there, would boost your profit up to \$524,548.74, and taking also my estimated expense into consideration of \$254,800.29, would give you a profit of \$779,349.03, or an income of \$779,349.03, which would be—could be used for expenses.

Mr. Farmer: You said that was without any improvement on reserves?

A. That is with improvement up to April 10th on the reserves, the actual improvement.

Q. Up to April 10th?

A. Yes.

Q. And the total amount of the improvement for the whole year 1941 on the contract basis is \$1,050,000?

A. I estimated it around \$1,050,000, that is, using the different rates of improvement. Of course, you can't tell the exact figure on that, but that is including an estimation [fol. 2617] and the actual figure. Also for the year 1942, if no improvement was made to the reserves and the securities were practically the same as they are now, if there were no—not a lot of sales or somebody didn't go out and sell a lot of them and we were allowed to reinvest the income and also any called bonds that we would have to turn over, we were allowed to invest that income, I estimate the income from this to be \$952,831.97, with expenses of \$153,699.23, total amount of net income \$799,132.74. Of course, this estimation of expenses does not include any extraordinary expenses of the trustee or trustee's fee, because I don't know what they are going to be.

Q. In other words, then, for 1942 on that basis you would not realize enough income to cover the required improvement of the reserves on the contract?

A. Well, it depends on a lot of—there is a lot of factors that enter into that. My estimation is made on the assumption that the reserves would not be improved. If they were improved—

Q. I am asking you—

A. Wait—

[fol. 2618] Q. Answer, if you don't mind.

A. I would like to elaborate on it first.

Q. First, this amount of the gross income is not as much as the required amount to be allocated for the improvement on the reserves would be.

A. It depends on what you call the gross income.

Q. Your figure there of \$707,000 would be gross.

A. That is net income.

Q. All right, what is gross?

A. Gross income is \$952,000.

Q. Well, gross is less than the amount required for the improvement on the reserve.

A. No, I wouldn't say that, for the reason that when you consider improving the reserves you also have to consider interest on contract loans that I did not consider in this income for 1942. If we stop the improvement to the reserves we also have to stop the interest on our contract loans that the contract holders pay us, so that we—I can-

not say—you cannot say that the income that I have estimated here could be applied against the amount of improvement that we had to put on the reserves, because you will [fol. 2619] have to take into consideration the interest on contract loans.

Q. What was the interest on contract loans?

A. \$82,000.

Q. All right, assume that you had the whole amount, \$82,000, and added that to your gross income, it would still be less than the improvement on the reserves required for the year 1941, wouldn't it?

A. It would be about the same.

Q. Well, it would be less.

A. Well, \$20,000.

Q. Less. And if you took the net income instead of the gross, the net income is how much less than the gross?

A. The net income is \$799,000.

Q. How much do you figure for expenses there?

A. \$150,000.

Q. So that you would be \$170,000 in the red, that is, if you figured improvements on the reserves for 1942?

A. Sure, but I don't see how you could figure the improvement on the reserves for 1942.

Q. Well, that is for the Court. Of course, you would [fol. 2520] not—

A. Because you have to take into consideration your contract loan interest.

Q. And you said that was \$80,000.

A. Approximately \$82,000.

Q. That is before your estimate of expenses? You didn't include anything for administrative expenses, court costs, trustee's fees and attorneys' fees, did you?

A. No, there isn't anything in here for that. I didn't know what to do or that.

[fols. 2621-2623] FRED RISLEY recalled, testified as follows:

Examination By Mr. Palmer:

[fol. 2624] Cross-examination.

By Mr. Lauritzen:

Q. Mr. Risley, I believe you testified a moment ago that after you changed the charter on December 31, 1940 to

that of a life insurance company and filed policies with the state and got a license and had Mr. Weaver work out rate books and so on, that you were doing everything you could to begin the life insurance company operation?

A. That is correct.

Q. Can you tell us, Mr. Risley, whether that included the contact with any of the various state insurance commissions to ascertain what their attitude was with respect to your company conducting a life insurance company in those states?

A. We did not reach the point of contacting any foreign [fol. 2625] states or insurance commissioners.

Q. Only West Virginia?

A. That is all.

Q. Do you know whether there were any conferences, informal or otherwise, along that line with anyone from the Illinois Insurance Commission involved?

A. Not of my own knowledge I do not know of any. Mr. Weaver or Mr. Messick may have contacted them. I couldn't say that they did.

Q. You do not know one way or the other?

A. No.

Q. Now, Mr. Risley, after the SEC injunction in 1938, it became apparent to the company that one of the things you would have to do from that point on would be to see that contract holders to whom you were selling contracts got proper information as to the nature of the company and the facts and figures behind it. Am I correct in that?

A. Yes, sir.

Q. The SEC's big criticism of Fidelity was that they did not disclose certain things to purchasers and prospective purchasers. Is that correct?

[fol. 2626] A. That is correct.

Q. Now, I would like to show you these booklets, Mr. Risley, that have been introduced here as Exhibits 83 to 87, inclusive, and ask you whether those booklets were worked up by Fidelity or anyone connected with it after the SEC investigation and injunction?

A. Yes, they were.

Q. Now, looking at Exhibits 83 and 84 and then looking at Exhibits 85 to 87, can you tell us which of them contains more detailed information or what the difference in them is?

A. Briefly and quickly, I would say that the later series of booklets contained greater information.

Q. Calling your attention to Exhibits 85, 86 and 87, containing the financial statement of securities deposited with each of the various states having depository laws and containing above that schedule what is known as a foreword. That foreword was not inserted in these earlier booklets. Am I right in that?

Mr. Reinhardt: If this witness is testifying on his present examination of these books, I submit that the Court can do that as well as the witness.

[fol. 2627] Mr. Lauritzen: I think he has testified he was familiar with them, Mr. Reinhardt. He was president of the company.

The Court: You are asking him, Mr. Lauritzen, what is in these booklets. They have already been introduced in evidence. Any question as to what is in them would be improper, because the Court already knows what is in them.

Mr. Lauritzen: All right; I think that is correct.

Q. Mr. Risley, after the SEC injunction did the SEC continue to keep a staff of people in Fidelity's office at Wheeling?

A. No.

Q. Not at all after the injunction?

A. No.

Q. Were conferences had between the representatives of Fidelity and the Securities and Exchange Commission as to what Fidelity should do so that it would not violate the injunction?

A. Frequently.

Q. Who had those conferences and with whom?

A. Mr. Koontz contacted them most frequently, and [fol. 2628] he reported his having them, I think principally with Mr. Klein.

Q. Mr. Robert Klein, Jr.?

A. Mr. Lane's assistant.

Q. Assistant to the general counsel?

A. Yes.

Q. And to your knowledge did the SEC know that these booklets which I have shown here, particularly 85, 86 and 87, were the booklets that were in use by Fidelity and were being distributed to contract holders and prospective contract holders?

A. I was informed that they had been submitted to them.

Mr. Reinhardt: Well now, I will have to ask to have that question and answer stricken, unless it is merely to prove that somebody told this witness that these had been submitted, because he testified that he does not know the fact.

The Court: Well, let's see if he does know. Do you know?

A. Only that the—Mr. Koontz was requested to submit the material to the Commission, and he reported back that [fol. 2629] he had and that they had no objection to the form in which he returned it. That is all I know about it.

The Court: All right. The Court can see the extent to which that is admissible. I overrule your objection.

Mr. Lauritzen:

Q. Mr. Risley, did the Securities and Exchange Commission at any time commence proceedings against Fidelity for contempt of the injunction decree entered at Detroit?

A. I believe they did.

Q. A contempt citation was issued?

A. No, I—I believe Mr. Lane went to Detroit, appeared before the council—or the court—but not—there was no citation issued to my knowledge.

Q. Well, do you know what action of Fidelity's he was criticizing at that time?

A. Let's see. I believe it was a statement—or a booklet prepared by President Thompson which was the chief objection.

The Court: Prepared by what?

A. Prepared by—for President Thompson, which was [fol. 2630] sent to the contract holders, explaining what had happened.

Q. Prepared by President Thompson? Is that what you said?

A. Prepared for him. It went out over his signature.

Q. Well, who prepared it?

A. I believe a man by the name of O'Brien that is in charge of the sales promotion department.

The Court: All right.

Mr. Lauritzen:

Q. Mr. Risley, as far as you know, the SEC, either by formal or informal action, never criticized your use of these booklets Exhibits 85, 86 and 87? Am I correct in that?

A. Yes, sir.

Q. And those were the booklets that you placed in use after the injunction and constantly used and delivered to all of your new prospects and purchasers? Am I correct in that?

A. You are right, sir.

Mr. Lauritzen: That is all.

Cross-examination.

By Mr. Reinhardt:

Q. Mr. Risley, so far as you know, clearance was never [fol. 2631] obtained from the Securities and Exchange Commission on any of these booklets?

A. By clearance you mean formal approval?

Q. That is right.

A. No, sir.

Q. Was informal approval ever obtained, so far as you know?

A. My understanding is that as far as the Commission went was to say that they had no objection to its use.

The Court:

Q. Who said it? This is the informal discussion that you are talking about.

A. Well, that, as I say, I understood that most of the conferences were held with Mr. Klein.

Q. By whom?

A. Mr. Koontz.

Q. So that any information you have about this is derived from Mr. Koontz?

A. Correct.

Mr. Reinhardt: Well now, your Honor, I understand Mr. Koontz is to come here and testify, and since he is the one who had these conferences, either this testimony is worthless or it should be stricken so it can be supplied by [fol. 2632] Mr. Koontz.

Mr. Palmer: If your Honor please, may I suggest, the question is what information the company had, and the information the company had would be the information given to the president.

Mr. Reinhardt: That is satisfactory.

The Court: If that is the purpose. I understood from Mr. Lauritzen the purpose would be to show, if he could, that certain statements in these booklets which were presented to contract purchasers in Wisconsin bore the approval of the SEC. Was that the purpose?

Mr. Lauritzen: Mr. Reinhardt, I think we can clear this up if you will just tell us, it is a fact, isn't it that the Securities and Exchange Commission under no circumstances ever issued an approval of any advertising document or prospectus issued by any issuer of securities?

Mr. Reinhardt: Absolutely.

Mr. Lauritzen: Now, let me ask this. If these booklets were in violation of the decree entered in Detroit at the suit of the Securities and Exchange Commission, I think that the SEC would have taken some action to stop them. Am I correct in that?

[fol. 2633] Mr. Ray: Your Honor, what has that to do with this proceeding—what the SEC might have done?

Mr. Reinhardt: Let me say this. In the first place, that comes under the jurisdiction of the enforcement division, not the reorganization division, and I feel a little out of my field in speaking about what the enforcement division would do. However, I understand that it might well be that the Securities and Exchange Commission would not take action even though it felt that these booklets violated the injunction, or it might further be that the enforcement division had not yet recommended that action be taken and that they contemplated action. I don't know what the fact is.

Mr. Lauritzen: Could you find out this, Mr. Reinhardt, whether the SEC wasn't fairly familiar and conversant with the facts that Fidelity was using these booklets, Exhibits 85-87, after the injunction decree?

Mr. Reinhardt: Mr. Jaegerman could do it for you.

Mr. Jaegerman: I would say the Commission was not at all conversant or familiar with the type of booklet the company was using. The Commission had the assurance of the company that a registration statement was in course

[fol. 2634] of preparation and would be filed in time, and then, of course, only an official prospectus might be used, and prior to the filing of the official prospectus the SEC doesn't examine any prospectus. If it were called to our attention that it was a gross abuse, we might go in and enjoin it or prosecute it criminally. I don't know whether it was ever brought to our attention in that manner. Certainly it was not brought to my attention.

The Court: The evidence will be admitted only so far as it shows that the company, through its president, was informed that Mr. Koontz had the conversation that the witness said he was informed that Mr. Koontz had. It seems to me that has very little bearing on the case, but it will be admitted for the limited purpose.

Cross-examination.

By Mr. Farmer:

Q. Mr. Risley, the company, you said this morning, in response to the Judge's question, in your opinion, probably could not successfully operate under the Investment Companies Act of 1940—that is, this new Federal Investment Companies Act—and lay aside its reserve to be accumulated at the rate of $3\frac{1}{2}$ per cent per annum compounded semi-annually, without appropriating to income—compounded annually, Mr. Reinhardt said.

A. I think that is correct.

Q. (Continuing.) Without appropriating to income sums paid in by contract holders who lapsed their certificates or who don't pay enough payments to have any surrender value?

A. I don't recall that.

Q. Well, I thought that was—

A. No, my statement was that the Investment Companies Act of 1940 required the creation of what they termed in the Act as deficiency reserve, if in the past the company had created reserves requiring a greater improvement rate than $3\frac{1}{2}$ per cent. The association was not financially able to create these deficiency reserves which would place the reserves behind each and every contract outstanding on a $3\frac{1}{2}$ per cent basis.

Q. Yes, sir, I understood about that deficiency reserve, that they would be required to do that, but I thought that

you also, in response to a question by his Honor, said that [fol. 2636] you were doubtful that the company could operate and continue to do business under the Investment Companies Act of 1940 and accumulate reserves on the basis of $3\frac{1}{2}$ per cent compounded annually.

A. If a hundred per cent of the contracts went to maturity, I think. Is that the question you are referring to?

Q. All right. Maybe that was the language he used. If a hundred per cent went to maturity, you could not do it?

A. No.

Q. Your experience has shown that quite a large percentage of contracts are not paid to maturity?

A. That is correct.

Q. As a matter of fact, from 91 to 93 per cent of the people who purchase those contracts do not pay them to maturity, according to the studies made by the Securities and Exchange Commission?

A. According to their study, yes.

Q. And the Securities and Exchange Commission found, and reported to Congress, that the company was only able to operate—"has been only able to operate in the ten year period 1927 to 1936 by appropriating to income sums paid in [fol. 2637] by people who buy the contracts and who either cease paying before the contracts have any surrender value or who withdraw their surrender value before that value has equalled the sum of the amounts they have paid in."

The Court: Mr. Farmer, that is not a fair statement of the question. I don't think it has been indicated by this witness that the company appropriated anything. You imply by your question that the company had to take money that belonged to some contract holder, and I don't believe that has appeared in evidence at all.

Mr. Farmer: I submit, if the Court please, that my question was absolutely accurate and fair. I was basing it on the report of the Securities and Exchange Commission, and I read from that report—

The Court: You are supposed to be basing it on a statement made by this witness.

Mr. Farmer: Well, I didn't, if your Honor please.

The Court: Let's hear the question.

(The question was read.)

The Court: In that question you are asking this witness to say what is in that booklet, and I think the question is

[fol. 2638] objectionable from that viewpoint, because the booklet is in evidence and the Court can see what is in it.

Mr. Farmer: Well, that is what it says.

The Court: They don't ask this witness what it says.

Mr. Farmer: My purpose was this. I wanted to show by this witness that the Securities and Exchange Commission investigated these companies, and this one in particular, and found that that was the way it was able to operate in the past, and I wanted him to go with me just one step further, and say that would be the only way it could continue to operate in the future.

The Court: Well, ask him that.

Mr. Farmer: Well, I was just leading up to that, and I would like to get him to agree with me up to the present.

The Court: It is not necessary for him or anybody else to agree with you as to what is in that book.

Mr. Farmer: You wouldn't disagree with me?

A. I would.

Q. You would?

A. And I have.

[fol. 2639] The Court: Let's go ahead with proper questions and not encumber the record with too much extraneous matter.

Mr. Farmer:

Q. You mean that you do not agree that the association was able to continue in business in the past by appropriating to income a large amount of installment payments in the early months after the issuance of the certificates?

A. It all depends on the meaning you place on the word "appropriated."

Q. Appropriated?

A. Yes.

Q. I mean they used it.

A. The Fidelity Investment Association never appropriated or confiscated one dollar of the accumulated reserve behind a contract while I was with them. Other companies in this type of business did, and not knowing what portion of the report you are reading, it sounds to me as though it covered the report on another company, not Fidelity.

Q. Well, this is on Fidelity, page 100.

A. As you may know, Mr. Farmer, the contracts of Fi-

[fol. 2640] delity provide a definite and fixed amount as an expense allowance, gross, of course from each payment that is made thereon, and in my seventeen years with the company that is the only money that was ever applied to the profit and loss account of the association from the payments made by contract holders.

Q. Don't you understand that this is what they mean, Mr. Risley, and isn't this a fact, that this is what is involved in the operation of the company—has been involved—that a large percentage of the people who buy the contracts, as you have just agreed with me, don't continue their payments long enough for the contract to have any surrender or reserve value, and then there are other people, in quite a large percentage, who withdraw their surrender value before they have paid in enough so that the surrender value equals what they have paid in?

A. That is correct.

Q. So that those people do lose money?

A. No question about it.

Q. They lose it. That is right. And somebody gets that money. They lose it, so what is their loss is somebody else's gain? Isn't that right?

[fol. 2641] A. It might be considered that way.

Q. Who gains from it?

(No answer.)

Q. The company?

A. Under the Fidelity plan the company would make more money from the contract holders that completed their payments than those that discontinued in the early part.

Q. You mean the company had to take that money and use a part of it to pay these old matured contracts, didn't it?

A. No, sir.

Q. Isn't it a fact that on these old maturing contracts that have been outstanding and paid up, that over this ten year period 1927-1936, the amount paid out by the company exceeded the amount that was paid in on those contracts?

A. That is probably true, but it is not income from the association that was used. Remember that in the creation of these reserves securities are purchased, and then when the maturity payments exceed the income, then it is up to the association to sell those securities that they have in the reserve to meet the maturity payments. You don't

[fol. 2642] have to touch the income of the association in any way, shape or form to pay out those contracts.

Q. But your company was established on this principle, and worked on this principle, that it was an essential feature of it that there were people, a large percentage of these people paid in their money, and they lost—lost all they put in.

A. The company was not established on that premise.

Q. Well, I say that was an essential feature of the operation of the company.

A. No, sir.

Q. Well, that happened—that did happen.

A. It happened, yes.

Q. It happened because under the contract they didn't get their money back unless they paid so much in such a length of time.

A. That is correct.

Q. So they lost what they paid in.

A. They lost a part of what they paid in.

Q. And if the company had not been able to retain those sums of appropriate them, as the SEC said, they would [fol. 2643] not have been able to operate as long as they did.

A. I am afraid you are mistaken there, Mr. Farmer: The actuaries that prepared our contracts created a reserve on such a basis that 100 per cent completion was contemplated. In other words, not one single contract had to default or discontinue its payment in order that the contracts might be paid in full.

The Court: Let me ask you this, Mr. Risley, and see if we can clear up this matter. When a contract was sold it was necessary to pay the commission on that contract, which was relatively large in proportion to the first annual payment.

A. Yes, sir.

Q. And it was also necessary to incur such other expenses in connection with carrying that contract, which, together with the commission that was paid out for selling it, as I understand, took up all of the first year's payments under your old contract, or substantially all.

A. Substantially all, yes.

Q. Now, if that contract ran on for the other nine years of its life the expenses to be charged against it were not [fol. 2644] very high?

A. No, sir.

Q. Was any more commission to be charged against it after the payment of the first?

A. No, the salesman received his commission, generally speaking, out of the first eight monthly payments. You see, the majority of our business was sold on a monthly payment plan, not on an annual payment basis; and then, following that, there was a fixed expense allowance from each monthly payment to cover the operating expenses of the association as long as that contract continued in force, and then under the proper management that allowance was sufficient to permit a profitable operation each month on that contract, and that is why I say that the association made more money—Fidelity Investment Association made more money on contracts that ran to maturity than those that discontinued in the early part.

Q. As I understand, then, on the contracts that were discontinued, the Association was protected against loss—against actual loss—by the fact that a greater percentage could be allocated to expense in the earlier years, but it [fol. 2645] would have got more profit had those contracts been carried to maturity.

A. Your Honor, there is a question that the association may have lost money on some of the contracts that were discontinued after one or two or three monthly payments. In other words, the cost of establishing the records suitable for 10 or 10½ years exceeded the net expense allowance above the sales commission to the association, so that I unhesitatingly say that the association did lose money on some of the business that was sold with only two or three monthly payments.

Mr. Jaegerman: And another source of great actual loss along that line, your Honor, would be what Mr. Risley has called deferred commissions advanced. Isn't this right? The company, in the past, at least, would make very substantial advances to the salesmen or sales agencies on these contracts on which two payments had been made—it would advance the commission assuming the balance of the payments would be made, and when they were not made that caused enormous loss.

The Witness: That was what caused our loss to the National Sales Agency.

[fol. 2646] Mr. Jaegerman: And that amounted to over a million dollars, didn't it?

A. That is correct.

Mr. Farmer:

Q. You say the company may have lost money on some of those contracts that they did not continue?

A. That is right.

Q. One thing is certain, that those people that took out those contracts lost money, didn't they?

A. Yes, sir.

Q. And the SEC reported that the overall loss to surrendered certificate holders for the ten year period was \$6,010,000, didn't it—page 109?

Mr. Huwe: I object and move that it be stricken.

The Court: Sustained. The Court is not going to permit any more reading from that book and asking witnesses whether that is in the book.

Mr. Farmer:

Q. Well, do you agree with that?

The Court: Objection sustained.

Mr. Farmer: I am on this point, if the Court please. Here is what I am leading up to and here is the unsoundness, as I see it—I may be all wrong about it—here is [fol. 2647] the unsoundness of this company and this type of companies.

The Court: I think I understand exactly your theory.

Mr. Farmer: Would your Honor state it?

The Court: It is that many, a great many, contract holders pay in money for their contracts which they never get back. Isn't that the whole of your theory?

Mr. Farmer: That is the first step, and the second step is that the company thrives on that, that but for that fact the company could not continue, as the SEC found. That is a very important factor in the operation of these companies.

The Court: Well, I think that the Court understands that that is true, but it is due to the fact, as has been brought out by this testimony, that commissions must be paid out of early payments, the first payments, and that certain other expenses must be set up out of those early payments which are not necessary in the later stage.

Mr. Farmer: Exactly. The poor man pays the salesman 18.9 cents of every dollar that he pays in that company and [fol. 2648] loses. The salesman gets 18.9 cents of it to

persuade him to put his money in and lose it in the company.

The Court: Of course, we have got to take into consideration the fact that that same thing would be true if he took out insurance.

Mr. Farmer: But not buying a Government bond, if your Honor please.

Mr. Palmer: If your Honor please, may I make this suggestion, something that is in the minds of both the Court and Mr. Farmer that has not been expressed, that there is, in addition to these legitimate expenses of paying salesmen's commissions and paying the expenses of the company from the payments during the early part of the life of the contract, that every lapsed contract, be it early or late, or surrendered contract, represents an actual profit to the company, and that is what Mr. Farmer is bringing out, that regardless of the fact that expenses and commissions are incurred, that there is a real and actual earned profit going into the company, and that that is what the report he is reading from has reference to.

[fol. 2649] The Court: That is what I was asking this witness, and this witness says that while that is true there would be a better profit had the contract not lapsed but had been carried on to its maturity. That is what I understand his answer to be.

Mr. Farmer: I would like to read your Honor something that has not been read and is not in evidence. It is the finding of the Securities and Exchange Commission on these companies in another part of their report to Congress, Part 2, page 228, this paragraph on that particular, and it says this—

The Court: Just a minute. The reporter is taking this down. I don't want any more books read into the record.

Mr. Farmer: I don't care whether this goes in the record or not.

The Court: All right.

(Mr. Farmer read, off the record, from the book referred to.)

Mr. Farmer:

Q. Do you agree with this, Mr. Risley, that in order for a company to have a chance to operate under this Investment Companies Act requiring the accumulation of re-

[fol. 2650] serves at $3\frac{1}{2}$ per cent compounded annually, it would be necessary to treat as income the payments paid in by the certificate holders who lapsed or surrendered their certificates before the surrender value equals the amount paid in?

A. It would be necessary for what purpose?

Mr. Farmer: Read the question.

(The question was read.)

A. That is a mighty difficult question to answer, because there are so many factors to be taken into consideration. If in designing the certificate to be sold under the present Act the loading was sufficient, and the management expenses were kept within that loading, it would not be necessary at all to rely on lapses or forfeitures or discontinuances. On the other hand, if the loading was placed low and calculations made as to the possible number of delinquencies, then it would be necessary to depend on that source.

Q. Well, is this not true, that the ratio of commissions paid out to salesmen to the installments paid in has been constantly rising? Hasn't that been the experience in the operation of this company?

[fol. 2651] A. There has been very little change in our company since 1932.

Q. Well, you don't agree with the SEC that reported that?

Mr. Warner: I object.

The Court: Sustained. We don't care whether this witness agrees with the SEC or not.

Mr. Farmer:

Q. Well, did you ever figure it up to see?

A. The difference, you mean, between the commission paid in 1934—

Q. To see whether it costs them more or less to sell these certificates?

A. The rate of commissions has never changed.

Q. I know, but the cost—the total cost—of selling has greatly increased, hasn't it? I mean, it has become increasingly more difficult to sell them?

A. I think you are right on that.

Mr. Farmer: Yes, that is what I am getting at. That is all.

Mr. Palmer: May I ask one or two questions, your Honor?

[fol. 2652] Examination by Mr. Palmer (resumed):

Q. Mr. Risley, isn't it a fact that the fundamental selling principle of the contract of this kind, particularly here in West Virginia, was that for every dollar of contracts sold there would be one dollar deposited with the state officials of the State of West Virginia which would be available to that contract holder in the event of any failure of the company?

A. That is not—not quite true, Mr. Palmer. The sales presentation was based on the fact that we would deposit with the State Treasurer of West Virginia 100 per cent of our cash liability on that contract, not for every dollar that was paid on it.

Q. Yes, you are correct. And that that fund would be available and under the control of the State Auditor in the event of any liquidation of the company? Wasn't that your selling point?

A. That was the selling point, yes.

Q. And wasn't that the point upon which you attempted to recruit or to sell to your salesmen the idea of becoming salesmen?

A. That point was used both in selling contracts and [fol. 2653] recruiting salesmen.

Q. Will you tell us whether or not an appointment for a conference with the Securities and Exchange Commission this year that Mr. John Marshall didn't want you to fulfill, and if so will you explain it?

A. Yes, I had an engagement with Mr. Carter of Mr. Schenker's division.

Q. Will you explain what Mr. Marshall's position was on your having that conference with—

A. I don't know just exactly what was in Mr. Marshall's mind, but he didn't want me to keep that appointment; he wanted me to just ignore it.

Q. And when was that?

A. It was some time, I would say, in the month of March.

Q. Of this year?

A. Of this year, yes.

Q. It is true, is it not, that what you have related about the inducement of the state securities law of West Virginia was the same inducement used in other states as well as West Virginia which had a similar or somewhat similar law?

[fol. 2654] A. I believe that was used, yes.

Q. And that included Illinois?

A. In recent years only, because—

Mr. Farmer: If the Court please, before we adjourn I have got a motion I would like to make about this meeting tomorrow. I would like to have about five minutes for that.

Mr. Palmer:

Mr. Risley, in your hearing before the SEC in January, 1938, isn't this a question that was asked you and an answer that was given:

"Question: Now, that 10 per cent figure that you gave us, what is that?"

"Answer: That was my estimate as to the probable amount of maturities. In other words, there was 90 per cent that was terminated in some other manner than going all the way through to maturity."

Do you recall that question and answer?

The Court: It is the same answer he makes now, Mr. Palmer. He says now that at least 10 per cent carried—

Mr. Palmer: I was trying to get that "at least" off, your Honor.

[fol. 2655] The Court: All right; if you can get that off, all right.

A. Well, of course I remember being there at that hearing, but I do not recall what I said at this time verbatim.

Mr. Palmer: May I show you the copy I have of the official report of the proceedings before the Securities and Exchange Commission by the Electreporter, Incorporated, official reporter, the question being on page 21637 and the answer on the same page, and ask you if you would say that you did not make that answer to that question?

A. I believe that that is correct as reported.

The Court: Now, Mr. Farmer has said he has a matter to take up, so I think we had better outline a little schedule for Mr. Risley in his subsequent testimony.

Mr. Palmer: I have several other questions here, your Honor, that I could finish in about three minutes.

The Court: I will give you three minutes, then.

Mr. Palmer:

Q. Mr. Risley, isn't it true that in answer to this question at that same hearing you said:

"Question: Mr. Risley, you say that the Virginia statute [fols. 2656-2669] requires—

"Answer: West Virginia.

"Question: The trustee holds funds for the benefit of certificate holders.

"Answer: Yes.

"Question: So that in the eventuality of any financial difficulty of Fidelity, it would have to be voluntarily or involuntarily liquidated, that pool of money, you say, unquestionably would go to certificate holders before your general creditors could come in?

"Answer: Yes, that is my information."

Did you give those answers to those questions?

A. I am sure I did.

Q. Isn't it true that at that hearing you said the normal turnover of your sales staff was approximately 80 per cent?

A. I believe so.

[fol. 2670] CARROLL D. EVANS called, as a witness by the state court receivers, having been duly sworn, testified as follows:

Direct examination.

By Mr. Palmer:

Q. State your name, please.

A. Carroll D. Evans.

Q. Where do you live, Mr. Evans?

A. Wheeling.

Q. Were you formerly connected with Fidelity Investment company?

A. I was.

Q. For how many years were you connected with that company?

A. About seventeen.

Q. From what period until what period were you connected with it?

A. April '23 to May '41.

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[fol. 2671] Mr. Palmer:

Q. Mr. Evans, what position or what part of the organization did you start with?

A. As a salesman.

Q. Will you tell us the various and successive positions you held with the company and the approximate time at which you made the changes?

A. I got the first part of the question but not the second.

(The question was read.)

[fol. 2672] A. I was a salesman in Pittsburgh for sixty days in the early part of 1923. I was thereupon made manager at Washington, D. C., where I was located for approximately two years. Thereafter I was more or less of a home office employee in the field, visiting various offices, for a period of I would say five years. Thereafter I was put in charge of Western Pennsylvania, Eastern Ohio, the State of West Virginia, and any southern territory which might have been open at that time. In February 1935 I was made director of agencies and continued in that position until May 1940.

Q. You said earlier, I believe, that you were connected with the company until '41?

A. I want to change that. It was '40.

Q. Were you ever a member of the board of directors?

A. Yes, sir.

Q. From what period?

A. As near as I can recall, I was elected to the board shortly after I became director of agencies in February 1935.

Q. And when did you cease to be a member of the board of directors?

[fol. 2673] A. It was either in April or May 1940.

Q. Mr. Evans, in your relations with the company did

you become thoroughly familiar with all of the selling aspects of this company?

A. I tried to become entirely familiar with all the selling aspects.

Q. Mr. Evans, what one feature, if any one, stood out above the others, and first interested you in becoming associated with the company?

A. There was one or two factors. The first one was the novelty of the plan. The second was the—I would say the West Virginia law, which required 100 per cent of the outstanding liabilities to be deposited through securities.

Q. With reference to that second—

A. I might augment that, but I felt that there was a great possibility for a career in the business, based on what I had observed up to that time.

Q. With reference to the feature of the West Virginia law, during the time that you were actively a salesman, did you stress that feature to the persons to whom you were attempting to sell contracts?

[fol. 2674] Mr. Ray: May it please your Honor, I don't see the relevancy of that. I object to that line of questioning.

The Court: Overruled for the present.

A. That was one of the features, Mr. Palmer, that was stressed.

Mr. Palmer:

Q. Now, Mr. Evans, will you tell us the sales condition of the company at the time you took charge in 1935?

A. Well, the sales condition of the company is, I think, most—could be most accurately reflected in the volume which was being produced at that time, and as near as I can recall it was on a basis of about one million or slightly over monthly.

Q. One million of what?

A. Well, that is face value—total face value of contracts sold.

Q. That was about the volume being produced monthly when you took over?

A. Slightly over a million dollars monthly.

Q. What was the setup that had existed just before you took over with reference to selling? How had the company

[fol. 2675] organized that, or what was the principal setup of it?

A. Personnel?

Q. Personnel and the organization. How did it work and how did it function?

A. My predecessors, of course, had charge of sales for the whole company. He had three supervisors as his assistants in the field, and under those supervisors and the director of agencies operated the various offices and the management of those offices and the salesmen.

Q. About how large an organization was there?

A. The organization was slightly over 400 registered representatives in the field.

Q. And what principal offices were there with reference to regional or state districts?

The Witness: Will you read that?

(The question was read.)

A. The principal offices at that time were Chicago, Philadelphia, Milwaukee, New York. There were at that time approximately 20 offices. I am giving you the four, as I recall, who were the leaders in volume at that time.

Q. And there were about 20 offices?

[fol. 2676] A. Yes, sir.

Q. Now, Mr. Evans, will you outline to the Court just what your procedure and plan was and what you carried out in the way of attempting to organize the sales end for selling purposes?

A. Because of the volume being comparatively low, the company was not then operating at a profit. In order to operate at a profit obviously it was necessary to increase the volume. The relationship between volume and profit is, of course, obvious, but in order to arrive at profit in the personal sales field you must have volume, and in order to acquire volume you must have representatives. The more representatives you have therefore the more volume you will have, and your profits will be correspondingly greater. With that as a basis I started a recruiting campaign having as its first objective a monthly volume of two million and a half, which, when acquired, it was assumed would have the outgo meet income.

Q. Had you been informed of that by the company officials?

A. Not by the officials. I think it was one of the statisticians [fol. 2677] who gave me that figure, as close as he could get it.

Q. When you say you started a recruiting campaign, perhaps the Court is not thoroughly cognizant of what you mean by that.

A. In the recruiting campaign you bend every effort to interest men in the business, train them and get them into production, and we put on a rather intensive campaign, because we wanted, as quickly as possible, to acquire volume which would put the operating end of the company on a profitable basis.

Q. When you reached the figure of two and one half million, then what did you discover?

A. We continued our recruiting and training—intensified the training.

The Court: Let's suspend a minute.

(There was a discussion off the record.)

Mr. Palmer: Will you give Mr. Evans his answer?

(The answer was read.)

A. For a period—the plan was based on a four year program, with an objective of more than five million volume, a month, and we were able to make that objective at [fol. 2678] a later date.

Q. Mr. Evans, it has been brought out in evidence here that the company had pretentious and somewhat expensive sales offices in the various cities. Will you tell us whether that was necessary for your selling campaign or your recruiting campaign, and if so why?

A. The usual method—we had three or four methods of getting men to the office, or rather interesting them in coming to have an interview.

Q. That is the men—

A. Prospective representatives, some of whom came from reference from friends or contract holders and some from newspaper replies and any other method whereby we might interest prospective—

Q. Before you answer my other question fully, will you explain to the Court what method you tried to interest prospective salesmen?

A. The bulk of them came from newspaper advertising, although our better salesmen came from those referred to us by contract holders or by friends.

Q. Now, will you proceed with your explanation as to why the pretentious offices were needed.

[fol. 2679] A. The offices, in the first place, were not all pretentions. We had some very modest offices. We had a number of offices where the office expense was less than \$50.00 a month, but in the larger centers where our supervisors were located we had more pretentious offices. It was in those centers where we had the greatest number of men, and we, of course, wanted to give the proper window trimming to the prospective salesman, the same as you might expect a guest to come to the house you would want to receive them in the best style. Well, it was necessary in these offices to have a space known as an assembly room, where morning meetings were held, instructions were issued, educational plans were carried forth. Sometimes those rooms had to have a capacity of a hundred seating capacity. But on the whole the offices were—we made an attempt to make the offices as presentable as possible.

Q. That was to put your best foot forward to the prospective salesmen to show them the type of company, to impress them with the fact that it was a good company, and in order to do that it was necessary, as you say, to put some window dressing up?

[fol. 2680] A. Yes, sir.

Q. Now, with reference to some of the salesmen and sales managers making from ten to twenty-five thousand dollars a year, was that necessary as window dressing in any way?

Mr. Ray: May it please your Honor, I don't remember any evidence of that.

Mr. Palmer: Mr. Evans will give the evidence.

Mr. Ray: Your question is based on evidence already in, Mr. Palmer.

The Court: I think it would be better to establish whether that was a fact before you ask him whether it was necessary.

Mr. Palmer: All right, your Honor.

Q. Mr. Evans, did any of the salesmen make from ten to twenty-five thousand a year, or sales managers?

A. They did.

Mr. Palmer: Now, will you read my question?

(The second preceding question was read.)

A. It wasn't necessary as window dressing, but it was very helpful.

Q. In what way? Will you explain to the Court?

[fol. 2681] A. Well, if you have a prospective salesman being interviewed this morning and you can point to someone who has been in the office a period of four or five or six or seven years who had also started as a salesman and what at the moment was making from five to ten thousand dollars a year, that should be very appealing to man out of a job and seeking a career in the sales field. As such it was very valuable information.

Q. Mr. Evans, tell us whether the cost of recruiting was high or small and what percentage of men you could get whom you interviewed and so forth.

A. As near as I can average, based on past experience, you would normally interview about a hundred men in order to recruit ten, and of the ten recruited ordinarily you would not find more than one who was able to produce an acceptable volume of business.

Q. Now, Mr. Evans, was it necessary for you or those under you at the home office to prepare literature for this recruiting of salesmen?

A. Yes, sir.

Q. And did you prepare that?

A. Personally I have assisted in that. It was done mostly [fol. 2682] by the sales promotion department.

Q. And was it done as a constant and steady thing, new literature going out at frequent intervals?

A. That is correct, making whatever improvements we could in the field as time went on.

Q. What, if anything, was done with reference to spending on newspaper or other forms of advertising for recruiting purposes only, I am speaking of?

A. That was an expense that was borne by the district managers and the supervisors for the most part.

Q. Was there some newspaper advertising and other advertising?

A. We had some newspaper advertising under the head of a national advertising campaign that was institutional advertising at the time.

Q. Under your supervision you started out with 20 office-, and I think you said about 400 men. Will you tell us whether you expanded that, and if so in what period of time and to what extent?

A. From February 1935 for a period of five years, approximately, that sales force was expanded from 400-odd men to more than 1800 representatives in the field. The [fol. 2683] offices were increased—branch offices instead of from about 20 to in the neighborhood of 60, as I recall, and we operated in 20 states at the end rather than the 17 which we were operating in when I took over.

Q. Now will you develop for us a little more fully, Mr. Evans—you said it was necessary to have volume in order to make a profit. By that do you mean that there were certain fixed expenses and that the proportion of volume increased to extra expenses is in lesser ratio, and that therefore the greater the volume the better the chance of making a profit?

A. That is correct; your administrative expenses remain practically constant regardless of the amount of volume. However, when you increase your volume you decrease the ratio of administrative expenses to the volume.

Q. When did you reach your peak of selling under your administration, Mr. Evans?

A. I think it was in November—would you mind if I refer to my—

Q. No, I would be glad to have you refer to any data that you have.

A. It is just a matter of dates. (Witness refers to [fol. 2684] papers.) The greatest volume attained in any one month during my office period was in September 1938, when we reached a volume of \$5,601,200.

Q. That is face amount?

A. Face amount—total face amount of all contracts sold.

Q. Mr. Evans, would you say that from the time you took charge there had been a gradual but steady increase up to that figure?

A. Yes. Well, in the main it was. In 1935 the total volume for the year was \$16,447,950; in 1936 it was \$25,513,800; in 1937 it was \$40,228,750; and in 1938, \$52,450,150. There might be some slight modifications of those figures, but they would not be very far off.

Q. Mr. Evans, what can you tell us as to whether or not the SEC suit in Detroit in December of 1938 had any effect upon your sales and whether the following receivership proceedings in the Northern District of West Virginia United States District Court had any effect upon your sales.

A. The sales volume, Mr. Palmer, in November of 1938 [fol. 2685] was \$4,790,600, and in December, when the SEC proceedings took place, the volume was \$2,958,450. In January—during January and February there was no volume.

Q. No volume at all?

A. That was in 1939. In March there was a volume of \$750,000, and that continued up until March 1940.

Q. What was the peak month after the SEC suit, and the amount of it?

A. August 1939 \$1,505,700.

Q. Was there any other month over a million?

A. Yes, sir.

Q. Will you just give us those months, without the figures?

A. From 1939, June, July, August, September, October, November, December and January of 1940, fell below a million, and the same applied to February and March of 1940.

Q. Mr. Evans, I don't think I asked you what part the sales room played, if any, that you had in your various cities with reference to helping those salesmen whom you recruited sell their prospective customers. Did that play any part in your sales, the fact that it helped to recruit sales-[fol. 2686] men?

A. No, not to any extent. Sales were mostly made in the field. Very seldom did any sale occur in the office.

Q. Mr. Evans, it has been said here in evidence that the sales force had an approximate turnover of 80 per cent or thereabouts per year. Can you give us any help on those figures?

A. I think that is a conservative estimate, Mr. Palmer. I think 80 per cent is very conservative. I think it would be a higher percentage of that, if a calculation were made.

Q. This has also been stated here, Mr. Evans, that approximately 15 per cent of the sales force produced the greatest bulk of your sales.

A. I think that is approximately correct.

Q. And about 10 to 15 per cent produced about what percentage of your total sales?

A. I would say between 70 and 80 per cent of the totals.

Q. It has been suggested from the witness stand here, Mr. Evans, that since 10 to 15 per cent produced the vast [fol. 2687] majority of your sales, that the thing to have been done by the sales end was to fire the other 90 to 85 per cent and you would have gotten along without such big offices and without such expenses and gotten along better. What can you tell us about that?

A. If the 10 or 15 per cent of your top rank salesman would continue on indefinitely as a permanent part of your organization, that would be a very fine solution to the problem, except for the fact that the 85 or 90 per cent of the salesmen producing 25 per cent of the volume, if you took those all off it would result in a loss of 25 per cent of the volume, for example, and a proportionate amount of the profit. A sales force in the personal sales field is an everchanging sort of thing. You have new leaders every month or so. Nothing remains constant. In order to attain a production figure, it is necessary to continue to recruit to the best of your ability in order to retain numerically a large number of salesmen. You can never tell when one who is in the lower bracket, below the 10 or 15 per cent, might suddenly become a star producer. Therefore, it is awfully hard, a very difficult matter, to say, "We will just shut off that 90 per cent [fol. 2688] and go on with the 10 per cent". That would be a disastrous thing, I am afraid.

Q. Isn't it also necessary to have this other 90 per cent in order to develop the 10 per cent that is good? Don't your star salesmen come from your entire group?

A. Oh, yes, that is true.

Q. Is it possible for you or any other man to recruit salesmen on the basis of background, appearance, and so forth, and to interview a prospect and say this man will be one of the ten per cent and this man will be one of the 90 per cent?

A. No, you can't do that.

Q. Is it necessarily a question of trial and experience in order to find out who are the good ones?

A. That is correct.

Q. And those good ones either go on up to higher positions with the company or go with some other company? Isn't that also true?

A. That is true.

Q. So that you have to continually be picking out a group and sifting them down and trying to find the hidden gems [fols. 2689-2700] in the large group?

A. That is, if you want to increase your volumes and profits that is necessary. If you want to be satisfied with a very small volume, your expense of recruiting could be cut down to a minimum, and your volume would be reduced and your profit would correspondingly be reduced.

Q. On the average, Mr. Evans, how many men would you have to interview to be able to finally get down to one of those men who belong to this group of 10 per cent of good producers? What would be the group number that you would start with?

A. It is a very general formula, Mr. Palmer, but I would repeat that in order to get one acceptable producer you would have to interview 100 men. Out of the 100 you would normally recruit 10. I don't know whether that would apply today or not, with the changed conditions, but it ran about that average. Now, I do not mean to say that the one who became a producer became a star producer, but out of that group he would very likely—more likely than out of the other group.

[fol. 2701] Q. Now, Mr. Evans, it has been stated here that there was a large group of salesmen just waiting for [fol. 2702] Fidelity to be reorganized so that they could again go into the field and sell. Do you know of any such group as that?

The Court: I don't think it was a group; a number.

Mr. Palmer: A number would be a better word, yes, sir.

A. I don't know that there is any large number of men waiting to return, from my own personal observation.

Q. If you knew of any, wouldn't you be attempting right now to get them into your present campaign that you are working on?

A. Yes.

Q. Do you know of any former salesmen who are just taking a stop-gap job in order to get back to Fidelity when it opens again, or if it does?

A. Not from my personal experience and observation.

Q. Do you see and contact a number of former salesmen of Fidelity in the City of Wheeling?

A. Not a large number, because there are only a comparatively small number in the City of Wheeling, Mr. Palmer.

Q. Do you know of any salesman who is waiting for Fidelity to reopen so that he can assume his selling job again?

A. I know of none.

Q. Now, Mr. Evans, you are conversant and familiar, are you not, with the past history of Fidelity over the last twenty years?

A. In a general way, yes.

Q. Will you tell the Court whether, if Fidelity were reorganized, there would be any sales resistance because of what has taken place in Fidelity over the last fifteen or twenty years?

The Court: That is, in his opinion and his experience.

Mr. Palmer: Certainly, in his opinion, based upon his experience, of course.

A. Based on my experience, I would assume there would be increased sales resistance, because of what has transpired in connection with Fidelity.

Q. If Fidelity were reorganized, Mr. Evans, can you tell us the approximate amount of money it would take to redevelop a sales organization?

A. No, sir.

[fol. 2704] Q. Well, can you tell us the minimum amount of money it would take to develop a sales organization?

A. No, sir.

Q. Can you give us any figures at all on what it would cost to build up a sales organization?

A. I can't give you any figures. I can generalize, if that is what you want me to do.

Q. All right, sir.

Mr. Ray: Your Honor, I think that is objectionable. What kind of sales organization and what is the sales organization going to do? Unless it is limited to something that fits the situation here—

The Court: Well, if this witness in his answer, will go into that and state what he has in mind, I see no objection to the question, so go ahead.

A. In reorganizing a company, or rather a sales force, to sell the contract of a company under present conditions, as indicated by my previous testimony would be a very difficult matter under present conditions, I believe. The more difficult it is the more expensive it would become, because in order to maintain what you would call recruiting units of men set aside to recruit salesmen in order to sell [fol. 2705] your product, I think you would have to pay them either a rather sizeable drawing account to get your better men or else a salary. Now, depending upon the extent of the sales force wanted—in other words, if you had a home office setup requiring the expenditure of a certain amount of money, you would have to sell so much volume at a certain profit in order to break even. Obviously, the first day you open your shop you haven't sold anything. Perhaps an hour later you do sell one, and so on down till you develop enough volume to take care of your expenses. It is like opening up any new business, where you have to get the business in before you start making a profit.

Mr. Palmer:

Q. Mr. Evans, would there have to be a large amount of money expended in order to get offices, recruit salesmen and develop salesmen, and a loss taken on that for some time before you could expect return upon that campaign?

A. Depending upon the size of your sales organization wanted and the number of states you want to operate—the number of cities you want to operate in, whether you want to do the job on a gradual basis of starting very small [fol. 2706] and developing, or whether you want to start right in and put on a sizeable campaign immediately, would determine the profits and the period of time in which those profits or losses will take place.

Q. You said it took 1850 men to produce a sufficient volume so that Fidelity could operate at a profit during the—

A. No, I didn't say that, Mr. Palmer.

Q. How many men did it take, approximately, Mr. Evans?

A. There was a profit—as I understand—I won't vouch for these figures, because they would have to be checked. A small profit in 1936 from operations, something like \$14,000, I have it here; and at the end of 1936 we had 766

in the organization, of whom 352 were producers. In other words, 352 men producing enough to meet the expenses as of that time. That is very approximately.

Q. Mr. Evans, will you give us, as best you can, from your experience and judgment, what it would cost to build a sales organization up to that figure that you had at the end of 1936?

[fols. 2707-2712] A. I have not the slightest idea.

Q. Well, could you give us what you figured the cost per man to train a good salesman?

A. I haven't figures on that, but it is again a sifting out or weeding out process. Coming back to my original illustration of 100 men interviewed in order to get 10 who would start to work, in order to get one who would become a producer, the cost would be considerable. It could easily be a couple of hundred dollars per man. I mean per producer—per outstanding producer.

Q. And that is when you have already got your recruiting setups in existence. Now, if you had to build that recruiting setup, would it double that figure of a couple of hundred dollars per man or not?

A. Well, it depends on volume. That recruiting setup would be absorbed from the income or profits the salesmen made. I wouldn't know whether—

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[fol. 2713] Mr. Palmer:

Q. Mr. Evans, is it your opinion that if Fidelity were reorganized it would do better by being reorganized as a life insurance company or as a face amount securities company?

A. I think it would fare very much better as a life insurance company.

Q. With that answer in mind, would it fare better in operating as a reorganized company of Fidelity, or would it fare better in being taken over by another reputable life insurance company and run as a part of it?

A. My opinion, which might not be worth anything in this case, because I have confined myself to sales work and not reorganization, would be that because of the fact that any [fol. 2714-2723] life insurance company which might take over the assets of this concern, already having an administrative setup and sales setup, branch offices, et cetera, would

be in better shape to administer the service—that is, what it is going to be for some time, I think, service to these contract holders than a concern which would have to be reorganized from the ground up.

Q. So that your answer would be that if it were to be a life insurance company, it would be better that it be taken over by some other operating company?

A. I think so.

[fol. 2724] Q. Then for the most part these ten to twenty-five thousand dollars a year men were paid from commissions which resulted from their work?

A. That is right.

Q. In your opinion, did these men who received large remuneration earn what they received?

A. Yes, sir. When I say—might I amplify that?

Q. Yes.

A. When I say earned it, I mean to say they are men greatly experienced in organization work, and they were able, because of their experience, to develop a sizeable [fol. 2725-2727] enough sales force to pay them rather handsome returns, whereas one less experienced—and we had those in the organization too—couldn't make that much return.

[fols. 2728-2733] Q. Having in mind the best interests of the contract holders, can you answer this question, should the company be liquidated or reorganized?

A. I can't answer that question.

Q. You can't answer that question?

A. No, sir.

[fol. 2734] Mr. Lauritzen:

Q. Mr. Evans, we had some discussion last evening. Didn't you at that time tell me that \$500,000 would not be an out of the way figure as a minimum amount that would be required for that purpose?

Mr. Ray: I object to that, your Honor.

The Court: Overruled.

Mr. T. C. Townsend: That is a basis for contradiction, I guess. Will you contradict him?

Mr. Lauritzen: I am just trying to bring out what the facts are if I can, Mr. Townsend.

Mr. T. C. Townsend: I just wanted to find out your attitude.

The Witness: May I have the question?

(The question was read.)

A. That is correct.

Mr. Lauritzen: Mr. Evans, after the SEC proceedings you testified that the company's business for several months [fol. 2735] fell to nothing, and I believe your testimony was that it never did revive up to anywhere near the volume to which it had been built before the SEC investigation and injunction. I am correct in that, am I?

The Witness: Your question, please.

(The question was read.)

A. To what it had been immediately preceding that time—the volume immediately preceding that time. We had volume in 1939, after the SEC investigation, which was comparable to the volume back in for example 1935.

Mr. Lauritzen:

Q. And what volume was that in dollars, Mr. Evans?

A. For 1935?

Q. No, the highest figure to which you built after the SEC injunction?

A. After?

Q. Yes.

A. \$1,505,700.

The Court: Per month?

A. One month, yes, sir.

Mr. Lauritzen:

Q. That is \$1,500,00—?

A. Yes, \$1,505,700.

Q. That is the fact amount per month?

[fol. 2736] A. Yes. That was in August, 1939.

Q. That is the best you did since the SEC injunction?

A. That is correct.

Q. Didn't you testify awhile ago that when you took over the general sales management that it was deemed necessary for Fidelity to sell, first, a figure set at \$2,500,000 per month,

and later a figure that you tried to build up as high as \$5,000,000 a month, in order that the company could operate profitably?

A. That is right; it was approximately two million and a half per month which we were hitting at to make the company—

Q. So what sales you were successful in building after the SEC injunction, those sales were never successfully built to a point where the company could operate profitably?

A. Not on its then basis of operations.

Q. Now, Mr. Evans, considering these proceedings that we are in now and considering that prior to these proceedings there were state court proceedings in West Virginia and also in Wisconsin and Illinois and Ohio and numerous other states, can you tell us, from your experience, [fol. 2737] whether you do not believe that those proceedings will have at least as serious a result on the resumption of any possible sales campaign as did the SEC proceedings in 1938?

A. They would certainly have an effect.

Q. Do you think that effect will be as great as the SEC effect?

A. I couldn't tell.

Q. Mr. Evans, can you tell us of the contracts sold during the thirties prior to Series B, what percentage of the total gross payments on those contracts went for furnishing selling expense?

A. In what period?

Q. Sales commissions I mean. During the thirties, prior to the time you commenced selling Series B.

A. I do not have any figures on that.

Q. Do you have the amounts, Mr. Evans?

A. No.

Q. Mr. Evans, considering the fact that under the Investment Companies Act of 1940 the total loading permitted both for sales, commissions and for all other expenses is an amount equal to 7 per cent of the gross annual [fols. 2738-2739] payments on a particular contract, for instance, \$84 on a \$1200 contract, can you tell me whether you believe that if this company were reorganized and an attempt were made to carry on its sales activities in a manner and size comparable to those previously carried on, whether those sales activities could be carried on on that loading?

A. They might possibly be carried on, but they most certainly would be curtailed.

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[fol. 2740] Q. When you were head of the sales department would it have been easier for you or harder for you, speaking of you as the head of the department, to recruit salesmen had you reduced the amount of commissions you paid?

A. Obviously it would have been more difficult to recruit [fol. 2741] salesmen with reduced commissions.

Q. Would you have been able to sell a greater volume or a less volume of face amount contracts had you reduced the commissions to the salesmen?

A. Based on my previous testimony, when you reduced the recruiting activities, therefore it would reduce your volume.

Q. Now, had the company reduced the amount which it would have given at maturity to a contract holder, would that have increased or reduced your volume?

A. Depending upon factors of time and payments—monthly payments—it would reduce the appeal.

Q. Keeping all other factors the same and reducing only maturity amount, would that have reduced your sales volume?

A. I think so.

Q. Had the company, keeping other factors the same, reduced the rate of improvement on reserves, would that have reduced the volume?

A. I think so.

Q. Each one of those factors played a part in composing the whole to make your total sales? Is that correct?

[fols. 2742-2745] A. That is right; everything that detracted from the general attractiveness of the plan would certainly reduce its distribution.

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[fols. 2746-2747] Q. And you stressed the factor of safety, that they had a hundred per cent of safety by virtue of the deposit laws of this state.

A. That is right. And in other states, whatever the state law was.

Q. And in other states, "if you don't have a hundred per cent safety law, West Virginia has such and we have deposited the balance there to make up what your state doesn't have"?

A. That is right.

[fol. 2748] Q. On the basis of what you now know about the improvement rate and its relation to the contract and the safety factor of the contract, would you now say that a contract with a high improvement rate is more or less attractive than a contract with a low improvement rate?

A. I would reverse myself on it.

Q. When Mr. Lauritzen was examining you, he brought out that you had told him last night that \$500,000 would not have been an unreasonable figure for certain purposes that he specified. Have you changed your mind since last night?

A. Only to this effect, that any large sum—I spoke of \$500,000, but it might have been \$200,000 or \$300,000, but a substantial amount of money would be required to develop the sales force to the place where we had before. I might have said \$200,000 or \$100,000 inadvertently in the course of conversation; it wasn't a definite opinion. I still have in mind a substantial amount of money, because I couldn't determine that.

Q. In other words, your answer now is what you testified on your direct examination, that you don't have the slightest idea.

A. That is right. There might be a variance of \$500,000, \$100,000, \$200,000 or whatever it is.

[fol. 2759] TOM B. FOULK called as a witness by the Tennessee contract holders, having been duly sworn, testified as follows:

Mr. Farmer: If the Court please, I desire to make this statement. I don't regard it as an altogether amenable practice to subpoena lawyers to testify, and I would not have subpoenaed Mr. Foulk and Mr. Arthur Koontz in this

case but for the fact that one of the witnesses gave some testimony which I thought made it material for them to appear here and testify as to the facts and advice that they had given their client, owing to their familiarity with many of these matters that were essentially legal matters, [fol. 2760] and it was for that reason that I reluctantly subpoenaed Mr. Foulk and Mr. Koontz to be here.

Direct examination.

By Mr. Farmer:

Q. This is Mr. Thomas B. Foulk?

A. Yes, sir.

Q. Your home is in Wheeling, West Virginia, I believe, Mr. Foulk?

A. It is.

Q. And you are an attorney there?

A. I am.

Q. How long have you practiced law in West Virginia—how long have you been a member of the bar of West Virginia, Mr. Foulk?

A. Twenty-seven years this month.

Q. Practicing all that time in Wheeling?

A. Yes.

Q. I believe you at the present time are the commissioner for the selection of juries for the United States District Court for the Northern District of West Virginia?

A. At Wheeling.

[fol. 2761] Q. At Wheeling. Without compensation, Mr. Huwe says.

A. \$5.00 every time I draw a jury.

Q. Have you been connected with the Fidelity Investment Company, later Fidelity Assurance Association, in the past?

A. I have.

Q. What has been your connection with that company?

A. Well, I have been general attorney and a director during the past seven or eight or nine years, and one of the vice-presidents during a part of that time.

Q. I believe you held the position or title of general counsel?

A. Never.

Q. Never general counsel?

A. No.

Q. Just an attorney for the company.

(No answer.)

Q. General attorney?

A. Correct.

Q. And you were a director on April 10th and April 11th of this year?

A. Yes.

[fols. 2762-2765] Q. And also on June 6th you were a director.

A. I was not.

Q. You were not a director then?

A. No.

Q. Did you cease to be a director between April 11th and June 6th?

A. I think I resigned about the 27th of May, 1941.

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[fol. 2766] Q. After the injunction was granted in Detroit, in December 1938, state whether or not the Securities and Exchange Commission had representatives or accountants who stayed for some period of time at the home office of the company at Wheeling?

A. I don't know of any attorneys who were there after the injunction, but during the receivership proceedings there were two accountants there constantly around. In fact, they stayed around until the receivership matter had been determined. They had some cleanup work to do, and I think that one of them, Mr. Ben Jackson, had a report that he was working on that he had to submit in order to complete his task.

Q. Do you know the name of the other?

A. Fisher.

Q. You said after the receivership proceedings. Was that different from the Detroit suit?

A. Yes.

[fol. 2767] Q. That is a receivership bill that was filed in the federal court—

A. United States Court for the Northern District, Honorable W. E. Baker, Judge.

Q. When was that filed?

A. The 22nd day of December 1938. Correct that—19th of December 1938.

Q. What date?

A. 19th day of December 1938.

Q. And when was that dismissed?

A. I am not certain, but I believe about the 9th of March, 1939.

Q. And during that period you say that Mr. Jackson and Mr. Fisher were there?

A. Correct.

Q. And afterwards, did you say, or not?

A. Correct.

Q. Some time afterwards?

A. Yes, sir.

Q. Do you know about how long afterwards they remained there?

A. Well, I am pretty certain they were there in the [fol. 2768] middle of April. I remember one occasion in the April Term of court I was called from the courthouse; Mr. Jackson wanted to assure me that he was not working on any new matter, but really wanted the records to complete the old task prior to the injunction.

Q. When did the board of directors first give consideration this year to the type of proceedings or the court to which the affairs of the company were to be taken? Well, I will put the question this way.

A. I don't know just what you mean by that.

Q. State whether or not the company ceased to issue any new contracts on December 31, 1939.

A. '40.

Q. 1940?

A. That is correct.

Q. And prior to that time the charter had been amended, as the record shows, to convert the company into an insurance company?

A. That is correct.

Q. And had the directors determined to convert the company into an insurance company so that it would engage in business as an insurance company?

[fol. 2769] A. That was the action, I think, of the 31st of December, 1940.

Q. Was it the intention of the directors to convert the company into an insurance company after that time?

A. It was.

Q. When did it appear that that could not be done or that court proceedings would be necessary?

A. Well, as I recall, Auditor Sims, while he allowed licensees to issue to some of the salesmen, at the same time

had a gentleman's agreement that no business would be solicited. I think the officials went ahead to the point of having some policies printed, but no insurance policies were ever sold—no business of any sort was ever sold after the 1st day of January, 1941.

Q. Did you know anything about Mr. Sims, the State Auditor, writing a letter to Mr. Arthur Koontz with regard to his intention to take some sort of court proceedings? I refer to the letter a copy of which is filed as Exhibit 94 from Mr. Sims to Mr. Arthur Koontz. Did you see that letter or learn of it having been written about that time?

A. No, I don't recall seeing that letter.

[fol. 2770] Q. Was there a meeting of directors of the company shortly before Mr. Sims instituted his proceedings in the Circuit Court of Kanawha County, West Virginia, in April of this year?

A. Let me answer that in this way. I had a call from Mr. Koontz that matters were serious for Fidelity, and that he would like me to come to Charleston, and my ledger shows that I came here on the night train April 3, 1941, and on April 4, the following day, Mr. Risley and Mr. Latta and Mr. F. J. McNulty and I were in Mr. Koontz' office and we did spend several hours considering the possibilities and what could be done, with the attitude of Auditor Sims to invoke court proceedings.

Q. You did not attend a meeting of directors?

A. Yes, but that was the following week.

Q. The following week?

A. That was Monday, April 7th, and I think perhaps the meeting was recessed until April 8th.

Q. Well, what decision was reached with regard to those matters at those meetings?

A. Well, tersely stated, the situation could not be remembered [fol. 2771] died; they felt that they could not conform to what the Auditor desired; and I believe a resolution was passed employing the firm of Koontz & Koontz to represent the association in prospective litigation.

Q. Were you contemplating that the company would be liquidated or reorganized—and when I say "you" I mean the board of directors.

A. Well, the discussion was that under the statute—I think it was 3325 of the 1937 Code—the Auditor would go into the Circuit Court of Kanawha County; and it was felt,

under the language of that section and the power of administering the assets, that he could have the reorganization there desired. The plans of reorganization were entirely nebulous, but they were all talking of reorganization.

Q. Nobody had any very definite, concrete idea about it?

A. None except Mr. Latta.

Q. Mr. Latta?

A. Yes.

The Court: What plan did Mr. Latta have?

A. Judge Moore, he did not set it down on paper. He [fol. 2772] had had experience in several reorganizations, and I remember a very healthy discussion in the library at Koontz & Koontz's office, but I couldn't repeat other than they had a plan of some equitable whittling from the contract holders.

Q. Well, did he have a plan which was discussed and which impressed his associates as being a possible and feasible plan?

A. Mr. Risley and Mr. Koontz and I were impressed with it, yes. I should say, answering fully, that Mr. McNulty was not.

Mr. Farmer:

Q. Was the question of a reorganization through the federal court—bankruptcy—was that considered or discussed at that time?

A. No, I don't recall, back in Wheeling on the 7th and 8th of April, that very much discussion was given along that line. I think the matter was rather determined here, for after spending several hours in discussion in the library of Koontz & Koontz Mr. Arthur Koontz and I went up to see Auditor Sims, and Mr. Justice was there at that time.

Q. And what message were you to convey to Auditor [fol. 2773] Sims?

A. Well, we told Mr. Sims that we were giving the matter serious consideration; and he assured us again that he was going to act, that he had referred the matter to the Attorney General; and I recall that he questioned what procedure we thought advisable, and I think it was Mr. Koontz who facetiously responded, "That is a peculiar thing to ask us to write our own prescription for our death knell."

I recall one thing—I don't know whether it was Auditor Sims brought the matter up or Mr. Justice; it rather impressed me and I think it impressed Mr. Koontz—that some years ago the National Surety Company had been in financial trouble, and the New York Insurance Commission had requested certain cooperation from the Insurance Commissioners of other states, and as a matter of comitty, courtesy, he got that, and Auditor Sims was very much pleased with the way that had worked out, and he said then he felt that the matter could be held under control, if it was decided upon, in the state court; it would be convenient for him and for the Attorney General to handle the [fol. 2774] matter, and that he intended to send telegrams to the insurance commissioners in the various states, and I think Mr. Justice said he had the telegram pretty well formulated that he expected to send out to the various states asking that they hold the reserves deposited and all matters for the action they expected to take care of it.

Q. Was Mr. John Marshall, Sr. in accord with the views of the rest of you gentlemen and Auditor Sims at that time?

A. I don't know how to answer that, Mr. Farmer. I don't remember—I don't remember any strenuous position.

Q. Did he make any objection to the proceedings in the state court on the ground that it ought to be in the federal court?

A. Not that I recall.

Q. Did anybody make insistence that the proceedings ought to take place in the federal court and not in the state court?

A. No, there seemed to be unanimity, as well as I recall. Four of us had been down here and had considered the matter, and told, as completely as we could, the various matters that had been discussed. As I recall—another thing that I believe was done, either Monday or Tuesday, April 7th or 8th, a committee was appointed to consider plans for reorganization; and if I am not mistaken Mr. A. G. Messick was named chairman of that committee. Then along about five o'clock in the evening of April 8th, I understood that Mr. Robert J. Riley had been employed by that committee. Mr. Riley telephone-me that he had been employed by the reorganization committee and wanted some advice about their work. I said, "Well, you

are moving too fast for me; I don't know just what you have in mind."

Q. Who is Mr. Riley?

A. He is an attorney of Wheeling, West Virginia—a very capable attorney.

Q. Who are the members of that reorganization committee besides Mr. Messick?

A. I never heard the personnel, but on Wednesday, April 9th, Mr. Riley told me that he was going to Charleston, going with Mr. Messick, Mr. Pulfer and Mr. John Marshall, Jr.; and then he talked to me that evening, the evening of April 9th. He was back in Wheeling and said [fols. 2776-2778] they had been out to see Mr. Partlow, Assistant Attorney General, and had gone over the bill of complaint and had made some suggestions.

Q. That bill of complaint was later filed in the state court?

A. The bill of complaint was filed in the Circuit Court of Kanawha County, West Virginia.

Q. Well, did the board of directors authorize Mr. Koontz or Mr. Koontz's firm to appear in that suit in that proceeding in the state court?

A. Yes, I stated that, and that action was never revoked as long as I was a member of the board.

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[fol. 2779] Mr. Farmer:

Q. State whether or not it was the consensus of opinion of you gentlemen who were directors and officers and attorneys for the company, perhaps other than Mr. Fleming, that the only fair chance of a reorganization of the company [fol. 2780] would be as an insurance company, with the voluntary concurrence of contract holders and the various state officials and depositories through proceedings in the state court—Kanawha Circuit Court.

A. Well, that is a pretty broad question. I wouldn't want to undertake that—to answer for all of them. I felt that so far as an investment company was concerned that we were done. I couldn't see any possibility to carry on in the investment field. We couldn't qualify and go ahead under the Investment Act of 1940, and I felt that that type of business had had its day. As an insurance company, if we could work into that, I felt that there was a possibility

of placating our people and having them comfortably go along.

Q. Well, was it, or not, the opinion of the directors, or officers and counsel for the company, until Mr. Fleming appeared on the scene, that the interests of all the parties in interest in the company and the contract holders especially were adequately and properly taken care of through the proceedings in the state court that Auditor Sims had instituted?

A. Yes, I think they all felt that the Circuit Court of [fols. 2781-2802] Kanawha County was adequate to carry through.

[fol. 2803] Q. Mr. Foulk, you have been familiar, particularly since 1938, to a great extent with the services Mr. Koontz rendered the company in a legal way, have you not?

A. I think so.

Q. And you were also familiar, to a general extent, with the fees paid therefor, were you not?

A. Yes.

Q. Isn't it true that there were services rendered for all fees paid and that the fees charged were reasonable for the services rendered?

A. Well, I will answer that in this way, Mr. Palmer, if I may. I never felt any of his fees were out of line with [fol. 2804] what I would have charged under similar circumstances if I had been able to furnish the service he did.

Q. It would have been substantially the same amount?

A. I never passed upon his fees except as a member of the board. It was the duty of the general counsel to consider and to audit the legal bills and to pass them on to the board for approval and payment. I don't recall of any fee bills from Koontz & Koontz that were repulsive to me as being exorbitant.

Q. And you considered them reasonable?

A. All reasonable and fair, so far as I can recall. Do you have one in mind?

Q. None in particular, Mr. Foulk. Mr. Foulk, the services that were rendered by Mr. Koontz, were they necessary services to the company?

A. Absolutely.

[fol. 2805] Q. Now, Mr. Foulk, coming to the period of this year, the early part, it was determined in the latter part of 1940 that Fidelity could not go on as an investment or face amount securities company. Isn't that true?

A. Yes.

Q. And as you have stated, in your opinion, that type of business, I think as it has been expressed here before, was dead dodo. Is that correct?

A. Well, I don't know how it has been expressed here before.

Q. In your opinion that type of business was through entirely?

A. That is my personal opinion about it, Mr. Palmer. I felt disconsolate after I read and made some little study of the Investment Act of 1940. I have no adverse criticism to level. I just felt that we never could make the grade.

Q. It appeared to you that the Investment Companies Act of 1940, whether intentionally or otherwise, had legislated the type of business that Fidelity had been doing out of [fol. 2806-2819] existence. Is that correct?

A. It made it pretty difficult to follow.

Q. And, I say, your opinion was that it had actually or practically legislated that type of business out of existence as a practical matter?

A. Oh, I don't know that I want to characterize it that way, Mr. Palmer. If you mean the net result was that Fidelity could not continue under that rather precise and somewhat onerous legislation, yes, I felt Fidelity could not continue and could not live.

Q. So that Fidelity turned to the idea of a life insurance company as a means of continuing existence? Isn't that true?

A. That is true.

[fol. 2820] Cross-examination.

By Mr. Lauritzen:

Q. Mr. Foulk, after you got the charter as an insurance company, do you know whether anyone from the company made an effort to contact insurance commissioners in the various states to determine whether you could get under way as an insurance company in those states?

(No answer.)

Q. Speaking of states other than West Virginia now.

A. Yes, Mr. McNulty and Mr. Risley had some contacts and Mr. Cattelle, of the Lincoln National Life—I believe he is an actuary—came to Wheeling, and then Mr. Messick brought to us a Mr. John Weaver, an attorney of Chicago, who at one time I think was president of the Postal Life, and he stated that Mr. Weaver would be an invaluable man in getting us qualified as an insurance company in the various states, as he was familiar along that line. Just how far Mr. Weaver went I don't know, because that was in January of 1941, and Auditor Sims' attitude was pretty pronounced from the middle of January on.

Q. Did you get a license or qualify as an insurance company in the State of Virginia?

A. No.

Q. Do you know whether any of the officials in Virginia were approached by anyone for Fidelity in that regard?

A. I do not, but I think not.

Q. Do you know whether the insurance officials of the State of Illinois were approached by anyone for Fidelity to see what the prospects of getting under way there as an insurance company were?

A. I think I was told that Mr. Weaver had made some overtures in Springfield, Illinois.

Q. Do you know what the result was?

A. I do not.

Q. Do you know of any other overtures that were made in states other than Illinois?

A. No, I do not.

Q. Do you know whether anyone connected with the company made any investigation to determine whether or not the company would be able to get under way as an insurance company in the various states?

A. I can only say, Mr. Lauritzen, that I understood Mr. [fol. 2822] Messick had left that matter to Mr. Weaver.

Q. There was some mention here of Mr. Weaver having prepared a booklet of some kind, apparently a rate book or something of that sort. Do you have any information on that, Mr. Foulk?

A. Well, I think that is partially true. He brought to us a gentleman whose name I cannot recall, on the 31st of December, and that man made some compilation of figures and some submission. I don't think Mr. Weaver prepared a rate book exactly.

Q. This man Cattelle that you spoke of, will you tell us a little bit more about him?

A. You let your voice drop after Cattelle, I didn't hear the rest of it.

Q. Can you tell us a little bit more about him as to who he was?

A. Well, he is the chief actuary of the Lincoln National Life, Fort Wayne, Indiana.

Q. Mr. Foulk, can you tell us when you first became acquainted with Mr. James R. Fleming, the counsel for the debtor in this proceeding?

A. I don't know the gentleman, Mr. Lauritzen. I was [fols. 2823-2825] here when this case opened in August. I happened to be in Huntington on a matter and I wanted to come over here and be here on the opening day, and I saw Mr. Fleming in the courtroom, but I was not introduced to him and I have never met him.

Q. Up until the time you resigned as a director of Fidelity on April 22, 1941, did you know whether or not Mr. James Fleming had any connection with Fidelity?

A. He had no connection—if I understand your question, he had no connection as long as I was associated with Fidelity.

Q. Had he done any work for it as long as you were associated with it?

A. Not to my knowledge. I think Mr. Messick made some mention of him at that time. The name Fleming meant nothing to me—on the meeting of April 7th or April 8th, but I can't go beyond that.

[fol. 2826] Q. Then, of course, you were here in Charleston conferring with Mr. Koontz and others with reference to the affairs of Fidelity?

A. Yes, sir.

Q. And the financial difficulties in which Fidelity found itself?

A. Yes, sir.

Q. You were trying to find a way out, is that right?

A. Yes, sir.

Q. And then it was the purpose of the meeting in Wheeling on the 7th to devise means of working Fidelity out of the situation in which it found itself?

A. Rather.

Q. And then you decided, did you not, from the time you first began to discuss it, that the only solution for it was [fol. 2827] to go into the state courts? Didn't I understand you to say that or in effect that?

A. Well, I suppose we are aiming at the same thing, Mr. Townsend. Of course, I don't want to quibble about it. Mr. Messick said he called the meeting of April 7th, notice for which was sent out about the 27th or 28th of March—he said he called the meeting because he felt it his duty as chairman of the board to acquaint the board with the fact of the financial—desperate financial situation that was existing. That meeting was called before I came down here to Charleston for that consultation at the instance of Mr. Keontz, and when you asked the other question as to the board of directors deciding what court to go into, why I remember that that was a matter of—not ridicule; it was a matter of some concern and some jesting, that we had no prerogative in the matter particularly; the Auditor had the right to choose his forum. We felt that the Auditor was considered in the matter.

Q. You thought that the Auditor had the exclusive right to suggest the forum for a reorganization of Fidelity.

[fol. 2828] A. We did not feel that he had a reason to lean on us to indicate a—

Q. Well, the Auditor suggested going into the Circuit Court of Kanawha County.

A. The Auditor was willing to go, as the board indicated.

Q. Well, the board indicated the Circuit Court of Kanawha County.

A. The board indicated it had no objection and would not contest the matter if it was filed.

Q. And nothing else was suggested except to go into the Circuit Court of Kanawha County?

A. I think there was some discussion as to whether that was preferable to the federal court.

Q. And it was decided that it was?

A. Yes.

Q. Do you think that way about it yourself?

A. Yes, I will have to say, in fairness to myself, Mr. Townsend, that I have never had a case in the federal court, so it was onesided knowledge on my part which I sent to the board.

Q. It was just about the unanimous consent of the board [fol. 2829] of directors and the parties who met from April

3rd down to April 8th, that the only place to reorganize Fidelity was in the Circuit Court of Kanawha County?

A. I think Mr. Messick offered the two possibilities that they might consider. I think he fairly presented the matter.

Q. Well, what was said with reference to going into the federal court? Were the advantages and disadvantages of it discussed at all?

A. They were not presented by me.

Q. Was Chapter 10 ever mentioned—

Mr. Palmer: Wait till Mr. Foulk finishes his answer.

The Witness: That is all right. I am trying to answer Mr. Townsend.

Mr. T. C. Townsend:

Q. Was Chapter 10 ever mentioned in the course of these suggestions?

A. I think Mr. Messick presented the matter, as I recall it, the two possibilities.

Q. The possibility of reorganizing under Chapter 10?

A. I think so, as I recall it.

Q. Is your recollection clear about that?

[fol. 2830] A. Pretty clear, Mr. Townsend.

Q. Did Mr. Koontz discuss it?

A. Mr. Koontz wasn't there.

Q. Well, you were down here in Charleston discussing it with Mr. Koontz.

A. All right, let's go slowly. We were talking about the director's meeting.

Q. I am asking you another question now.

A. Yes, Mr. Koontz—

Q. And you were talking here in Charleston with Mr. Koontz and the staff of Mr. Koontz's office with reference to reorganizing Fidelity, weren't you?

A. Yes.

Q. And you never discussed at all the possibilities of reorganization under Chapter 10 and in the federal court? Is that right?

A. No, that is not right.

Q. Did you discuss it?

A. Yes, sir.

Q. In the federal court?

A. You are talking about the Koontz office in Charleston?

[fol. 2831] A. I am talking about the Koontz office in Charleston.

Mr. Palmer: May I suggest that the court reporter can't possibly get that examination? I am only making that suggestion, so we can all hear it and get it.

Mr. T. C. Townsend: The reporter hasn't complained yet.

Q. Let me get it clear. While you were discussing this matter with Mr. Koontz and Mr. Koontz's staff, you discussed state courts and federal courts?

A. I didn't discuss the federal courts.

Q. Well, did anybody—

A. Will you let me tell you?

Q. How?

A. You want me to answer, don't you?

Q. Yes.

A. Well, give me a chance.

Q. Well, I thought you had it.

A. Did anyone? Yes. Mr. Goldsmith had had considerable experience, and mentioned several cases, and Mr. Koontz had had experience; but, Mr. Townsend, from the federal end I had had no experience, hadn't made a real [fol. 2832] study of the Chandler Act, and I wasn't able to contrast the cases.

Q. They did?

A. Yes.

Q. In your presence?

A. Yes.

Q. And what was their conclusion?

A. Their only one was that the state court was adequate to give the reorganization desired.

Q. Why?

A. I think it was a matter chiefly of expedition, for the Auditor to have the advantage of the Circuit Court of Kanawha County.

Q. Did they discuss it because it was advantageous for the Auditor or because it might be best for the contract holders?

A. They talked about the contract holders considerably and decided that both the Auditor and the contract holders would fare better in the state court.

Q. Did you not, at this meeting in April, when you discussed this matter with Mr. Koontz and considered the

question of reorganization, know you had to control all the [fol. 2833] assets of Fidelity before you could promote a plan of reorganization?

A. Yes.

Q. Was that discussed?

A. Yes.

Q. How did they propose to get the control under a state court receivership in Kanawha County?

A. Well, I think I stated that we hadn't thought that entirely through, but the Auditor suggested that the Insurance Commissioner of New York, in the National Surety case, had had a very co-operative working relationship and the assets had been conserved by the various insurance commissioners, and actions had been prevented.

Q. And because that was suggested, you thought that was the thing to do?

A. Oh, yes.

Q. And Mr. Koontz thought that was the thing to do?

A. I was impressed by what had been done in that instance.

Q. Then Mr. Koontz and the legal staff of Mr. Koontz's office thought that was the thing to do because Mr. Sims had [fol. 2834] suggested it. Is that right?

A. I don't know that anyone was present except Mr. Sims and Tom Foulk when the Auditor suggested that.

Q. You thought at that time the state court was preferable?

A. Yes.

Q. Do you think so now?

A. I do.

Q. And it can be reorganized better in the state court than it can in the federal?

A. I don't believe I can answer that. You say better?

Q. More successfully—I will put it that way.

A. Well, I still could not contrast the two. I think the state court is adequate, and I confess, as a states-righter I somewhat prefer the state courts.

Mr. T. C. Townsend: Now—

The Court: Wait, Mr. Townsend. He says, as a states-righter, he prefers the state court.

Mr. T. C. Townsend: May I ask him a question?

The Witness: Certainly.

Mr. T. C. Townsend:

[fol. 2835] Q. In this discussion in Mr. Koontz's office, did he tell you he had ever discussed any plan of reorganization with SEC?

A. I don't know that he did at that time, Mr. Townsend, but I think several weeks before that that he and Mr. Risley had been over with a Mr. Carver at the Securities and Exchange Commission in connection with the plan for reorganization.

Mr. Ray: Did Mr. Koontz tell you he had these discussions before the state court receivership was filed and that the Securities and Exchange Commission had advised him that it was the Commission's opinion that the reorganization should be in the federal court under Chapter 10?

Mr. Reinhardt: I object to that, your Honor.

Mr. Palmer: I object.

Mr. Reinhardt: There is no such evidence in the record.

Mr. Ray: I think there is a letter here that pretty clearly shows it.

The Court: I don't think that there is a letter that shows that anybody told Mr. Koontz that. You are talking about Mr. Marshall, I suppose.

[fol. 2836] Mr. Ray: I am talking about the letter from the member of the Commission in which it recites what he stated to Mr. Koontz about the way it should be reorganized.

The Court: I didn't remember that.

Mr. Ray: I may be wrong. May I look at the letter?

Mr. Palmer: The letter was read in evidence.

Mr. Ray: The part I am asking about is the part that was read.

Mr. Palmer: Let's have the whole letter. I would like to see the whole letter, as a matter of fact.

The Court: The Court is not going to let you see a private letter. This letter was put in here by reason of something that you brought out, Mr. Palmer, that the Court said was improper and should not have been mentioned, but it was mentioned and it got into the record, and now, if Mr. Ray can find any such allusion in the letter, I will be glad to know about it, so I can rule.

Mr. Palmer: For that reason, your Honor, I think your Honor's ruling is correct, that there is something in the

letter about which Mr. Ray has asked which has not been [fol. 2837] in evidence, and it would be only right that the counsel should see the rest of the letter to see what was said on that particular subject.

The Court: No question about that.

Mr. Palmer: That is what I had in mind.

Mr. Reinhardt: I was under the impression that Mr. Ray was referring to that part of the letter that had been read in evidence.

Mr. Ray: I am referring to it. If it is not in that part, of course I will withdraw the question.

Mr. Farmer: You had the whole letter, didn't you, Mr. Ray?

Mr. Ray: We will have to go back and check the record.

(There was a discussion off the record.)

The Court: Mr. Ray is right about that. The letter in question does state that the Commissioner who wrote the letter had a conference with Mr. Koontz relative to a proposed plan of reorganization, and that the Commission indicated at that conference that it would be unable to render a favorable report on any plan which did not comply substantially with the standards of Chapter 10 of the Bankruptcy Act.

Mr. Palmer: Your Honor, I believe that was a part of the letter that wasn't read before.

Mr. Reinhardt: This is a part that was read, but that is substantially different from what Mr. Ray said.

Mr. Palmer: And that occurred on May 9th, I am advised, and not prior to the receivership.

The Court: Read the question.

(The question was read.)

Mr. Ray: I will amend the question to say that any member or representative of the Commission had expressed an opinion that it should be.

The Court: The expression is, not that it should be in the federal court, but should conform to Chapter 10 of the Bankruptcy Act.

Mr. Ray: I will amend the question in that way.

Mr. Palmer: Your Honor, this letter was April 9th, after the state receivership proceedings, and it does not say when the conference with Mr. Koontz was held. This question

asks if it didn't say something before the state receivership was brought.

Mr. Ray: Mr. Foulk testified when Mr. Koontz was before [fol. 2839] the Commission.

The Court: Since this part of the letter is in evidence, that there was a conference and that such a statement was made to Mr. Koontz, I think this witness may be asked whether or not that was discussed in his conversation with Mr. Koontz.

A. I think Mr. Koontz told me on the 4th of April that he felt the Securities and Exchange Commission favored the federal court.

Mr. Ray: Did he state that at the directors' meeting on April 7th?

A. I have said three times, Mr. Ray, that he was not at the directors' meeting.

Mr. Palmer: Nor was he a director at that time.

Mr. Ray:

Q. Did you advise the directors of that opinion of the Securities and Exchange Commission?

Mr. Reinhardt: That was an opinion of Mr. Koontz, your Honor.

The Court: Well, I understand that.

The Witness: Now, wait a minute. I don't know what the question was.

(The question was read.)

[fol. 2840] A. No, I didn't advise them of any opinion from the Securities and Exchange Commission.

The Court: Well, did you advise them that Mr. Koontz had made that statement to you, that he felt that the Securities and Exchange Commission favored reorganization in the federal court rather than state court?

A. I don't know. I don't know whether that statement was made on April 7th or not.

[fol. 2841] The Court: We might save time by reading into the record again this part that does concern the matter. It is in there once, but it may as well go in now. I believe perhaps that two paragraphs of the letter ought to

be in the record to make the matter complete and I will read them in. This is from the letter to Mr. John Marshall signed by Robert E. Healy, Commissioner of the Securities and Exchange Commission, dated May 9th, 1941.

"I believe your informant is in some confusion as to what has actually occurred. Mr. Jaegerman and other members of the Commission's staff have been constantly in touch with representatives of Fidelity, including Mr. Koontz. A few weeks ago a proposed plan of voluntary [fol. 2842] reorganization was submitted to the Commission informally by Mr. Koontz. He requested an informal expression of the Commission's views. The plan was carefully considered by the Commission. Upon such consideration the Commission indicated that the plan was of such a character that it was very doubtful whether the Commission would be able to render a favorable report thereon under the Investment Companies Act of 1940. The Commission further indicated that it would be unable to render a favorable report on any plan which did not comply substantially with the standards of Chapter 10 of the Bankruptcy Act in relation with corporation reorganization, and further that in its judgment it was very doubtful that a plan of reorganization could practicably be effected without resort to the reorganization procedure of Chapter 10.

"In view of the series of consultations which have taken place between representatives of the Commission and representatives of Fidelity, and of Mr. Koontz's request, the Commission considered it fair that Fidelity be advised of the Commission's tentative views. Mr. Koontz was so advised. It was my understanding that Fidelity did not [fols. 2843-2845] concur in the Commission's idea that a reorganization could most successfully be effected under Chapter 10, and that instead a voluntary reorganization in the West Virginia state court is being attempted."

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[fols. 2846-2850] Mr. Gray: If the Court please, may I make a motion before we adjourn? I will be very brief, your Honor. It is a motion to dismiss and vacate the order, and pursuant and in support of the answer and petition filed in this cause by Edward J. Hughes, Secretary of State of Illinois, and by the Treasurer of the State and the Receiver. I am offering this motion at this time, your

Honor, because of the local character of the evidence going in now, and in view of the statement of the Court that there was no demarcation between the close of the petitioner's evidence and the defendants'. I would like to have this considered at the close of all the evidence, and in case the petitioner produces further evidence, but I understand they are through and it is because I will not be able to be here Monday or Tuesday of next week.

[fol. 2851] Mr. Gray: If your Honor please, I am asking leave to file this motion, and by the way, my train leaves at 9:50, and I will make a brief statement about the order which I am suggesting to the Court in connection with it, which is for the purpose of the pendency of your Honor's and such other courts as may be interested in the deliberation upon the reorganization processes; but I don't understand, in asking the Court to make this order clarifying the former order, that it is binding upon the Court in the event that proceedings to reorganize should fall down. In that event, I will consider the question anew to reinstate our objections and such suggestions in the proceedings as may be found necessary, and consider that the Court will enter such orders in that behalf by way of proper servicing of assets in the meantime. I have submitted to Mr. Reinhardt an order following our alternative prayer in the intervening petition which [fol. 2852] in substance permits the assets to remain up there until such time as they are needed in reorganization, or in the event that some new occasion would arise which might make it necessary for the proper administration of these proceedings by the Court.

Illinois has always taken the position that to have reorganization the Court in which reorganization is had must have authority to carry it out and must also recognize the pledges which may be impressed upon the property. We still take that position, and therefore, in that connection, I am tendering to the Court my views of an order which would relieve Illinois from the immediate attention of the Court in these proceedings, and I believe will not injure either party to the litigation. If your Honor will examine it later, whether you desire to enter the order or not, I will be very happy either way the Court disposes of it.

The Court: The Court has already seen the order that Judge Gray speaks about, and I am of opinion that the matters in the order are of no concern to any of the parties in

litigation other than the representatives of the State of Illinois and perhaps the Trustee. The order satisfactorily [fol. 2853-2854] clarifies the former order of the Court, with this understanding, which I wish to put on the record, that in entering this order the Court wishes to make it clear that in the event the jurisdiction of this Court is sustained in this proceeding, the Trustee of the Debtor is to have the management of the securities in the hands of the State of Illinois, with the right to sell and substitute, and also that in the final event no reorganization is had and the company is liquidated, the Court reserves the right at that time, subject to any objections of the State of Illinois, to require the funds to be liquidated through the Trustee.

Mr. Gray: The State of Illinois has reserved the right to object to that eventuality if the occasion arises in the future, your Honor.

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[fol. 2855] JOHN MARSHALL, SR., recalled, testified as follows:

Direct examination.

By Mr. Ray:

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Q. Did you attend a meeting of the stockholders of Fidelity Assurance Association held at Wheeling on October 3, 1941?

A. I did.

Q. Do you have the minutes of that meeting with you?

A. Yes, sir.

Q. Is the call for that meeting attached to the minutes?

A. Yes, sir.

Q. How was the meeting called?

A. It was called by having more than 1/10th of the stockholders—I think by sixteen stockholders owning more than 1/10th of the stock of the company.

Q. That call was in writing?

[fol. 2856] A. Yes, sir.

Q. What notice of the meeting was given?

A. A written notice to all the stockholders and certificate holders.

Q. Is a copy of the notice attached to the minutes of the meeting?

A. I think so. Yes.

Q. Is an affidavit that a copy of the notice was mailed to all of the stockholders and certificate holders more than ten days prior to the meeting attached to the minutes?

A. That is correct.

Q. Do you know whether any other publicity with respect to this meeting was given?

A. There was quite an extended account in the morning newspaper, and I understood that it was also broadcast on the radio, although I did not hear it.

Q. Please state whether or not a directors' meeting was held immediately after the stockholders' meeting?

A. That is correct.

Q. Do you have the minutes of the directors' meeting with you?

[fol. 2857] A. I do.

Mr. Ray: We now offer in evidence as Debtor's Exhibits

Mr. Palmer: Objection, your Honor.

The Court: Overruled.

Mr. Ray: (Continuing:) The minutes of the stockholders' meeting held on October 3rd and the minutes of the directors' meeting held on October 3rd.

Exhibits 98 and 99

The minutes of the stockholders' meeting were admitted in evidence, marked Exhibit 98, and the minutes of the directors' meeting were admitted in evidence, marked Exhibit 99, and the same are attached hereto as a part hereof.

Mr. Ray: The minutes of the stockholders' meeting, introduced as Exhibit 98, are found on pages 182 to 185, inclusive, of the minute book, and the minutes of the directors' meeting, introduced as Exhibit No. 99, are found on pages 186 to 189, inclusive, of the minute book.

Q. Mr. Marshall, will you state, so far as you can remember, what stockholders and certificate holders were present at the meeting in person?

[fol. 2858] A. Well, the stockholders' meeting was held in the sales organization room, the largest assembly room in

the building. The room was filled; I should say there were 40 or 50 people there, including some of the most prominent business men in Wheeling, and so far as I can ascertain practically all of the large stockholding interests were represented, Mr. Bachmann, Mr. Charles H. Copp, I think owns about 600 shares, an officer of the Dollar Savings; Mr. H. C. Hazelett, Mr. D. A. Burt, and quite a number of persons in the room I didn't know, but I should say it was as largely attended a stockholders' meeting as I have ever seen in Fidelity.

Q. Please state whether or not a resolution was presented to the stockholders' meeting ratifying, approving and confirming the action of the officers and directors of the company in instituting this proceeding for corporate reorganization of the company in the U. S. District Court for the Southern District of West Virginia?

Mr. Palmer: Objection.

The Court: Don't the minutes show that?

[fol. 2859] Mr. Ray: They do. The resolution is in the minutes.

The Court: That would be the best evidence of it.

Mr. Ray: I didn't ask him what it was; I just asked him if it was introduced.

The Court: Well, the minutes show that, don't they?

Mr. Ray:

Q. Mr. Marshall, will you refer to the minutes and read such portions thereof as represent any action taken at the meeting in respect to this corporate reorganization proceeding?

The Court: I don't think it is necessary for the reporter to take down what he reads from the book, because it is already in evidence.

Mr. Palmer: Wouldn't it be easier, your Honor, to read all the minutes, so we would be advised of them without having to reread them?

The Court: Yes, just let the reporter show that the witness read the entire minutes of both meetings.

(Thereupon the witness read the minutes.)

Mr. Palmer:

Q. Mr. Marshall, was that all the corporate action that had been taken?

A. If I understand your question correctly, the action taken by the stockholders and directors was reduced to the [fols. 2860-2865] form of minutes, and that is all the action.

Q. That is complete? No other action was taken?

A. No.

Mr. Palmer: Now, if your Honor please, we regret to have to challenge the right of Mr. John Ray to appear for the debtor. There is no authorization of any kind in any of these purported meetings of Mr. John Ray to appear for the debtor.

The Court: Overruled.

Mr. Ray: You must not want me!

Mr. Palmer: No, Mr. Ray, I assure you it is nothing personal; I want the Court to appreciate that; but I find nothing in the corporate minutes of any kind or in the stockholders' meetings authorizing Mr. Ray to appear for the debtor in these proceedings.

[fol. 2866] Mr. Palmer:

Q. Mr. Marshall, can you tell us how many shares of stock were deposited with you as trustee, both common and preferred?

A. I think the percentage was around 51 per cent, I think, of common, and I wouldn't be certain about the preferred. I think it was 54, perhaps.

Mr. Ray: Your Honor, if Mr. Palmer wants the record correct about that, the stock was deposited with a depository and the exact number of shares is shown in the tellers' report in the minutes.

Mr. Palmer: Show me that.

Mr. Ray: Right there at the end of the minutes.

Mr. Palmer: Which meeting?

Mr. Ray: The last meeting. The tellers' report is filed with the minutes of the meeting, I think. (Indicating.)

[fol. 2867] Mr. Palmer: This shows that at the meeting on October 3rd the number of shares of preferred stock deposited with the trustee was 4,769, undeposited, represented in person, 88; undeposited, represented by proxy, 54. Common stock, number of shares deposited with trustee, 4,801; undeposited, represented in person, 75; undeposited, represented by proxy, 100.

Q. Now, Mr. Marshall, getting back to your own shares, you said that you had 550 of common and 275 preferred. The 275 preferred was the result of a 50 per cent stock dividend? Is that correct?

A. That is correct.

Q. Of the 550 shares of common stock, how many of those shares did you buy?

A. Too many.

Q. Give us the number.

A. I can't do that, Mr. Palmer. I have been accumulating this stock—the first stock I bought must have been twenty years ago, from H. C. Ogden.

Q. How many shares was that?

A. I think it was 10 shares.

[fol. 2868] Q. Do you recall the price you paid for it, Mr. Marshall?

A. I think—my recollection is \$150 a share. I may be wrong about that. It has been a long time ago.

Q. Can you tell us other purchases you have made, to the best of your recollection?

A. Well, I remember I bought Colonel March's stock when the Federal Trade Commission was given supervision over security transactions. He had been a member of the board and a member of the investment committee, and I had gotten him interested in Fidelity, and he asked me to buy his stock.

Q. How many shares is that, Mr. Marshall?

A. I think he had—my best recollection is 50.

Q. Tell us some other stock purchases.

A. I think I paid \$155 for his stock.

Mr. Ray: Your Honor, I don't know the relevancy.

Mr. Palmer: I think it is to show the financial interest Mr. Marshall has in the company.

Mr. Ray: Is there any question about that? Who has denied that?

The Court: I overrule the objection.

[fols. 2869-2871] A. I think when Mr. Scandrett retired I bought some of his stock.

Mr. Palmer:

Q. About how many shares, Mr. Marshall?

A. I don't remember. Most of these purchases of stock, with the exception of my initial purchase, was from directors or persons with the company who for one reason or

another were ceasing their activities, and persons particularly that I had gotten interested, when they would ask me I would take their stock. I never responded to any advertisements or circulars offering stock for sale. I never have sold any.

Q. The shares that you bought, then, were necessarily in small amounts?

A. Well, when you buy 50 shares of stock and pay \$155 for it, that is not such a—

Q. I said, with the exception of those you mention, the rest were in small amounts?

A. No, I just can't remember. I have an indefinite recollection I bought some of Mr. Good's stock when he died. But I finally accumulated 750 shares, and I gave each of my boys a hundred which left me 550 of common stock.

[fol. 2872] Q. Mr. Marshall, when did you first start to take an active interest in the policies of the company?

[fol. 2873] A. I used to talk a great deal to Mr. Paull during his lifetime about it, but I never came on the board until after his death.

Q. All right, then; it was after his death that you began to take an active interest in the policies of the company. Is that correct?

A. Yes.

Q. Could you refresh my recollection as to the year of his death?

The Witness: Was it '22, Philip?

A Voice: About 1920.

Mr. Palmer: Mr. Marshall, isn't it true that in the 1920's, Fidelity sold a large number of securities from its portfolio with the expectation that the securities market would go down and they would be able not only to purchase those back but to purchase a larger amount of securities back?

A. When was that?

Q. In the 1920's.

A. I never heard of that, Mr. Palmer.

Q. When was Mr. Scandrett connected with the company?

A. I should say in the twenties, but what time I am not [fol. 2874] sure.

Q. Mr. Marshall, on the special annuity contract was there a reserve set up by Fidelity in accordance with the contract?

A. I assume so.

Q. Where did that reserve go?

A. What do you mean, where did it go?

Q. Just what I said, where did it go?

A. I don't know what you mean, Mr. Palmer.

Q. It is not there at present. Where did the securities go?

A. I don't know. I don't know what you are talking about. I am sincere; I don't understand you.

Q. You said that there was a reserve set up.

A. I did not.

Q. Beg your pardon. You said—

A. I assume so.

Q. You assumed so. You were actively interested in the company?

A. I am.

Q. And you were?

A. I was.

[fol. 2875] Q. Then you know that there was a reserve set up, don't you?

A. I am not going to discuss the technical features of the accounting method, because I don't know anything about it.

Q. As a substantial stockholder, why didn't you know where the reserves went or whether they were set up?

(No answer.)

Q. Answer my question, please.

A. I don't know what you are talking about. What do you mean? Where could reserves go?

Q. That is what I want to know.

A. I don't understand you. You mean where did the securities go that were—?

Q. Yes, sir, where did the securities go?

A. Well, they had an investment committee, a mechanism of handling the security transactions, and as far as I know there has never been any change with respect to that.

Q. Well, the present reports show that if the special annuity fund pays back its note to the other funds it would [fol. 2876] not have a nickel in it. Where did that money of the securities go, Mr. Marshall?

A. You will have to ask someone that is more familiar with it than I.

Q. I am asking the principal stockholder in the company and the man who took an interest in it. Where did it go, Mr. Marshall?

A. I have been here in the courtroom a good many days, Mr. Palmer. You could have asked all those questions from witnesses that were competent to testify. I don't understand what you mean, where did it go? You are not intimating that there was anything wrong about any of those transactions?

Q. I am asking questions only, Mr. Marshall, and making no intimations.

A. Well, I just don't understand what you are driving at.

Q. All right. In the special annuity fund at the present time the reserve set up for it, if it would pay back what it owes on its note to the other funds, there wouldn't be a nickel in that fund. Why?

A. Well, I don't know that that is true, in the first place, [fol. 2877] and I don't feel competent to answer it.

Q. Assume that it has been given in evidence by Mr. Isaiah Smith, an employee of the trustee, and accept it on that assumption, Mr. Marshall, why isn't there any money or securities in that fund?

A. I am not going to assume anything that I don't know anything about.

Q. Why didn't you know about it, as the principal stockholder and the man actively interested in the company?

A. Know about what, Mr. Palmer?

Q. About why there isn't any money in this special annuity fund?

A. I don't know that there isn't.

Q. I am asking you to take the figures of Mr. Isaiah Smith, an employee of the trustee, and if you don't know that there wasn't any money in it, why don't you know it?

The Court: Well now, Mr. Palmer, I think this witness has answered you—

Mr. Palmer: I think your Honor is right.

Mr. Jaegerman: Your Honor, for the purpose of the [fol. 2878] record, Mr. Smith never testified that about the annuity fund.

Mr. Ray: And, your Honor, if Mr. Palmer had wanted to find out where the securities and money went, he has had bookkeepers and accountants and statisticians on here day

after day who were familiar with the books and records, and these transactions were all on the books and records, and he should have asked those witnesses, if he wanted to know, where those securities went.

The Court: If you have any evidence, Mr. Palmer, that this witness took any of those securities wrongfully, then the Court wants you to put that in, and not convey that impression by innuendo by asking questions about it.

Mr. Palmer: If your Honor please, I don't think my questions carried that innuendo. I certainly did not so intend. I simply wanted to know why the principal stockholder of the company doesn't know where the funds set up for contract holders went to, and I think that is a proper question.

The Court: You were asking questions at the top of your voice with the evident purpose of in some way making some [fol. 2879] implication of wrongful conduct on the part of the witness. The Court doesn't want the record made in that way. If you have any proof of wrongful conduct, I am glad to receive it, but I don't want you to get that into the record simply by asking questions about it unless you have something to back those questions up. That was done in connection with the letter Mr. Marshall wrote, and the Court said at that time, and reiterates, that that was an improper thing to do in this case. I want you to govern your questions according to the statements I have just made.

Mr. Palmer: If your Honor please, I believe my questions have been directed at the knowledge of this witness. That is what I want to discover, his knowledge or lack of knowledge.

The Court: He has answered you a number of times and there is no use to pursue that any further.

Mr. Palmer: Now, Mr. Marshall, with reference to the special income fund, would your answers be the same concerning the reserves of it as they have been to my other questions?

A. Mr. Palmer, I am not going to attempt to explain [fol. 2880] situations with respect to particular reserves back of different contracts, because I am not competent to do it. I was active in Fidelity along many lines, but certainly not as far as accounting was concerned.

Q. You were, of course, the principal stockholder and as such directly interested in it.

A. I was active; I served on the investment committee; I served on the discount committee; I served on the executive committee and I served with the board of directors; and each day I was furnished with what they call the green sheet showing the individual sales of every salesman; I went over to the country to address all sorts of meetings of Fidelity; I certainly was active.

Q. Did you ever investigate as to whether or not the reserves required by the special income and special annuity policies were actually being set up?

A. I never specially investigated it, no.

Q. Did you know whether they were being set up or not?

A. All I would know is what the reports of the officers we have in charge would make, and I think I understood the [fol. 2881] situation as it went along from time to time as well as an ordinary director does, but—

Mr. Palmer: Will you read my question, Mr. Price?

(The question was read.)

Q. I am not certain that you answered my question directly.

A. What was being set up, Mr. Palmer?

Q. Reserves in special income and special annuity funds.

A. I am not going to try to particularize on certain contract funds, because I am not competent to do it.

Q. My question is to your knowledge, did you know whether or not they were being set up?

A. I assume, of course, that the reserves were being maintained for the maturity of the contracts.

Mr. Palmer: If your Honor please, I don't want to violate the Court's ruling, but I do think my question is a fair one and could receive a direct answer.

The Court: The original answer of the witness was that he knew as much about that as the ordinary director did, or as any of the others did, or something to that effect.

[fol. 2882] Mr. Palmer: I want to know his own personal knowledge whether he did know, and I ask the Court's permission to ask the witness to answer directly, yes or no.

Mr. Ray: May it please your Honor, I submit that when the witness said he saw the reports of the officers of the company, that that showed what his knowledge was.

The Court: Well, he ought to give direct answer and then such explanation as he cares to make, so, Mr. Marshall, the Court will require you to answer the question and then give such explanation as you have.

The Witness: May I have the question?

(The question was read.)

A. I think as long as I was active.—I mean, when I first became active, and subsequently, we had regular—not only annual audits but often reports monthly. I read those reports, studied them and discussed them, and was informed from time to time about our situations.

The Court: Did you know whether or not these reserves were being set up? That is the question.

A. I knew they were being set up, your Honor. I also knew that there had come deficiencies in them, and I knew [fol. 2883] that we took action to try to improve the situation.

Mr. Palmer:

Q. Now, Mr. Marshall, when did you first learn there were deficiencies in those two series of funds I spoke about?

A. I can't remember that; whenever it became apparent, because we were getting reports constantly about the affairs of the association.

Q. It was back in the 1920's when that became apparent from the reports.

A. You mean around 1929?

Q. Before 1930 you knew from the reports that you saw of the company's officers that these special annuity and special income series funds or reserves had deficiencies in them?

A. I knew that that was the time when our whole portfolio suffered very heavily from market quotation losses.

Q. Isn't this further true, Mr. Marshall, that when certain series of contracts became due in the early part of 1930 or thereabouts the company did not have the money to pay them, so they persuaded those persons whose contracts were coming due to take preferred stock in Fidelity [fol. 2884] in exchange for their maturing contracts?

A. I know that there was a stock unit—I think it had both common and preferred—authorized to be sold, and I

think, as a matter of fact, some contract holders made exchanges.

Q. Did you know that of the 5500 sold, nearly 5100 were from contract holders?

A. I didn't know what the figures were.

Q. You knew it was approximately that ratio, though, didn't you?

A. I knew that there was quite a number of contract holders exchanged their contracts for stock.

Q. You further knew that National Sales Agency at that time, the agency of Fidelity to sell contracts, was selling these stocks and at a commission?

A. That is right.

Q. And you knew that they were given a list of the contract holders as prospective sales?

A. I don't know who would give it to them. They had it themselves.

Q. They had it themselves. What was the contract made between Fidelity and National Sales as to selling the shares [fol. 2885] of preferred stock, or unit of preferred and common?

A. I cannot recall the details of it.

Q. Where would it be, Mr. Marshall?

A. I don't know.

Q. Would it be in the minutes of the board of directors?

A. That has been a great many years ago. I don't know.

Q. Where is the original sales contract between National Sales and Fidelity, Mr. Marshall?

A. I don't know.

Q. Have you ever seen it?

A. I don't know that I ever have.

Q. Was the contract made when you were actively interested in Fidelity?

A. I think that National Sales had a contract with Fidelity before I became interested in Fidelity.

Q. You think it was before 1920?

A. I think it was renewed from time to time.

Q. Beg pardon?

A. I think it was renewed from time to time after I became interested.

Q. You took part in the renewal of it?

A. That is right. There was quite a difference of opinion

among the directors as to whether we should sell the National Sales or whether we should contract to have our sales made.

Q. You were on the board of directors that approved the advances made to National Sales, were you not?

A. Yes, sir.

Q. You were on the board of directors when National Sales practically went out of existence owing the company a million dollars? Isn't that true?

A. That is right. I want to say, however, Mr. Palmer, that every advance that was made to National Sales Agency was recommended by the officers, and as I recall always supported by Fackler & Briby's certification that they had so much deferred commissions coming to them and that by experience the company would get that back.

Q. Mr. Marshall, as the principal stockholder and personally interested financially, therefore, didn't you investigate any of those situations?

[fol. 2887] A. I am just telling you I think we investigated very thoroughly when we had an actuary go over the figures and certify that we were exercising good judgment to advance up to a certain percentage that was due them. You understand they had deferred commissions coming to them if the contract holders kept up their payments.

Q. Didn't your experience with the company over a period of ten years show that the contract holders did not keep up their payments?

A. I am just saying Messrs. Fackler & Briby made that very calculation based on the experience of the company, but we ran into a very unusual period.

Q. The unusual period being from '30 to '35?

A. I should say it began about '29.

Q. And the unusual period lasted so long that you advanced them a million dollars?

A. But during this critical period was when the advances were made.

Q. Well, it ended up with your holding the sack for a million dollars? Isn't that true?

A. That is true.

[fol. 2888] Q. And you never cut it off before that time, did you?

A. Well, I think Senator Sutherland was president when the practice was finally stopped. I think he tired—he tried to be as careful as he could about it.

Q. And the practice was finally stopped by Auditor Sims coming with another gentleman to Fidelity and saying, "Either you will cancel your agreement with National Sales today or I will close you up." Is that true?

A. I wasn't—you understand I never have been in Wheeling. I have been an officer of the company in the sense—

Q. Did you know of that happening, Mr. Marshall?

A. I knew that Mr. Sims objected to the practice.

Q. You saw, did you not, the letters Mr. Sims wrote to the company in which he said he wanted all the officers fired and he wanted officers put in who knew stealing when they saw it and were opposed to it?

A. I think there was some such letter, and I think we complied with Mr. Sims' desire by having Senator Sutherland resign.

[fol. 2889] Q. I think that is correct. And until Auditor Sims of the State of West Virginia stepped in, you, as an attorney and as principal stockholder, had not stopped this drain on Fidelity through National Sales? Isn't that true?

A. I was a director, and I am not going to dodge any responsibility, Mr. Palmer. I am simply saying to you, however, that these things were done by the officers. I say, if I recall, the officers asked authorization to advance certain sums, and that is the way it was done; and it wasn't that we wanted to do it, I can assure you; it was considered good business judgment to do it.

Q. The officers you had a large part in being able to select by virtue of being the largest stockholder, did you not?

A. Well, I don't recall ever having any division in Fidelity about who should be selected officers. I think all our meetings were just about like it was yesterday. The only thing I can say is I had a great deal to do with getting members to come on our board.

Q. I said that you had the power, Mr. Marshall, by virtue [fol. 2890] of being the largest stockholder, and your family having several times as much as anyone else, to elect the officers.

A. No, I did not have the power to elect the officers. If there had been a division in Fidelity, which there wasn't, and there is not now, I could have only elected a minority of directors. The directors elect the officers. I have never been in position to compel people of Fidelity to do what I wanted them to do.

Q. But you were in position to exercise very strong persuasion, were you not, Mr. Marshall?

A. I was a very large stockholder, comparatively, yes.

Q. And as such could and did vote it?

A. Well, I think we might have to spend a good deal of time to talk about influence. For example, while I felt that Mr. Sims made a great many splendid contributions to this company and his ideas of economy were in accordance with mine, I would not have asked Senator Sutherland to resign.

Q. You had helped pick Senator Sutherland, hadn't you? [fol. 2891] A. I had.

Q. You helped pick Mr. Pole?

A. I did.

Q. You helped pick Colonel Thompson?

A. I was a director and voted for all those presidents.

Q. No, you just personally picked them and selected them and helped get them to be president? Isn't that right?

A. I was very active.

Q. Well, didn't you personally help do it?

A. Certainly; I was on the board of directors and helped do it, yes.

Q. Now, you personally——

A. I don't see how you want—how you separate me——

The Court: Mr. Palmer, I am not sure that I correctly get the purpose of your questions to this witness about his connection with the Fidelity company. If your questions are for the purpose of showing mismanagement on the part of the officers and directors of the company, I want to call your attention again to something that the Court [fol. 2892] has already expressed several times, I think, on the record, or if not on the record, at least openly, that it is not my intention at any times in the course of this proceeding to entrust any of the affairs of any reorganized company to any person who had anything to do with the condition in which this company had become involved. If any contrary impression was derived from the action of the Court in authorizing the stockholders' meeting, then I want to correct that, and say that the only purpose of the Court in authorizing that stockholders' meeting of yesterday was that the stockholders and directors might, if they legally could, correct any defects in the proceeding of June 3rd, and as to any control of the affairs of the company in this court, I repeat that they will not be

entrusted at any time to any of those persons. I don't know whether that was the purpose of your question or not.

Mr. Palmer: It was not the exact purpose, your Honor. Your Honor said that, and I had that in mind, so in order to find out who it is the Court should not entrust it to, I want to develop the facts from the man who knows it. I don't know whether the Court has in mind that Mr. Marshall is one of those persons that mismanaged it, or [fols. 2893-2904] whether the Court has in mind it was mismanaged, but I do think the facts should be developed from which the Court should form his opinion as just expressed.

The Court: I am glad to have the facts developed. Whether they are pertinent in this hearing is doubtful, but I am going to let you go ahead.

[fol. 2905] Mr. Palmer:

Q. Mr. Marshall, when was it that you first knew of a deficit in the general fund of Fidelity?

A. I don't know that I ever knew there was a deficit in the general fund except as it was a guarantee for deficiencies in reserve accounts.

Q. Well, when did you first know that there were deficiencies in reserve accounts other than the special annuity and special income?

A. I can't say the time, but I am certain I knew it as soon as it developed.

[fol. 2906] Q. You have heard a large part of the testimony here, and of course that has refreshed your memory. Can you tell us when that did develop?

A. No, I cannot.

Q. Did it develop as early as 1932?

A. I should think so.

Q. Did it develop as early as 1930?

A. I am not certain, Mr. Palmer.

Q. Then it is fair to state, Mr. Marshall, that from at least 1932, whatever the reason for it, Fidelity was in financial difficulties?

A. There was a depreciation on the market value of our securities. We, of course, had the alternative then to sell those securities and undertake to pay off the contract holders, and at market price we probably could have done it

at a certain time. We did hope, however, that the security market would come back, that we would be able to make earnings and supplement these reserves, and that is precisely what happened.

Mr. Palmer: Will you read the witness my question?

(The question was read.)

A. There were difficulties in that respect.

[fol. 2907] Q. Mr. Marshall, when you said you could have paid the contract holders off, but chose to go on, were you influenced in that by reason of the fact that you were the largest stockholder and had the most to lose?

A. No, I said that I didn't think at market prices we could have paid the contract holders off, and it is difficult for me, of course, to analyze my own motives, but I will say it was the judgment of all the officers and directors that we do just as we have done.

Q. I would rather you would confine your testimony, Mr. Marshall, if you will, please, unless I ask for it otherwise, to your own personal knowledge and your own personal actions, and my questions will be directed along that line, unless—

A. I understood you to ask me what my motives were.

Q. Yes.

Mr. Huwe: Your Honor, I think the witness has the right to qualify his answer any time it is necessary.

The Court: Go ahead.

Mr. Palmer:

Q. Mr. Marshall, you were on the payroll of Fidelity at least from 1931 on, were you not?

A. I can't remember the exact years.

[fol. 2908] Q. The report made by Mr. Gribben, which was introduced in evidence upon my request that he get all attorneys' fees back for ten years from the books of the company, showed that from—that during that entire period you were on the payroll of the company. That is true, is it not?

A. If that is what the book shows, I would not be sure.

Q. How many years before that were you on the payroll of the company?

A. I am saying I can't remember. I don't think before that—

Q. Beg pardon?

A. I don't think I was before that, but I may have been. Of course, you are also—I don't know whether purposely or not—confusing the firm of Marshall & Forrer with me personally. That is a partnership, and I am not the sole partner.

Q. I think I am not. The breakdown as given by Mr. Gribben shows that beginning January 1, 1931, John Marshall was on the payroll and the firm of Marshall & Forrer is given in a separate account.

[fol. 2909] A. In what capacity was I on the payroll in 1931?

Q. I am afraid you will have to answer that, Mr. Marshall. I don't know. You tell me.

A. I don't know that I was. I say when I became chairman of the board I was given a salary, just as the preceding chairman of the board was given one. When that happened, then is when I went on the payroll.

Q. Mr. Marshall, the books of the company, as put in by Mr. Gribben, show that you were drawing \$83.33 a month beginning in 1931. Do you deny having received that?

A. No, I don't deny having received it. I said whatever the books show is, of course, correct.

Q. For what services were you being so paid?

A. I think if that is the service—it was a retainer, just as your firm was getting paid in Charleston, except they were getting \$200 a month.

Q. My question, Mr. Marshall, is to you—

A. And I have answered plainly and definitely that it was a retainer—a legal retainer—and that is the amount of it.

Q. In addition to that retaining fee you, of course, received your necessary travelling and other expenses which you incurred in behalf of Fidelity?

A. Correct.

Q. Mr. Risley has testified that within the last ten years you also received a part of your office rent paid by Fidelity. Is that correct?

A. That is correct.

Q. How much?

A. Well, I think it was something under a hundred dollars. Of course, my office was used, you understand, by the investment committee for their meetings as well as my acting as chairman of the board.

Q. How much under a hundred dollars?

A. I can't remember. Do your books show there?

Q. That is not shown on this report. That is why I am asking you.

A. Well, I say it was under a hundred dollars, and I can't remember the exact amount.

Q. Why wasn't it shown on the books as a legal fee to you, as all the other legal fees were shown paid every other lawyer.

A. I do not consider that was a legal fee. I have just [fol. 2911] explained that my office was used not only as the office of the chairman of the board but as a place of meeting of the finance committee.

Q. What part of your telephone bills were paid by Fidelity?

A. Only such part as were long distance calls on Fidelity business.

Q. What part of your secretary or stenographer's fee was paid by Fidelity?

A. Well, at one time it apportioned—I would say not over \$50.00 a month.

Q. May I ask what proportion that was of her total salary? I judge it was a her.

A. I think her salary was \$125, is my recollection. I am not sure about those figures.

Q. Did you at that time devote the proportion that 50 bears to 125 of your time to Fidelity matters?

A. I remember once that she filled out some sort of questionnaire, and she said I devoted 90 per cent of my time to Fidelity.

Q. I am asking you what you say, Mr. Marshall.

A. Well, that is hard to estimate, but I devoted a great [fol. 2912] deal of time to Fidelity.

Q. When did this period occur that this was paid? For how long a time?

A. I think it was during the time that I was chairman of the board and that the investment committee meetings were held in my office.

Q. Would it be for a period of three years, then?

A. I should imagine possibly that.

Q. Was it at your orders that it was not set up on the books of the company as a legal matter?

A. Certainly not.

Q. Do you know at whose orders it was?

A. I do not. I don't consider it was a legal matter, however, if I had been asked.

Q. How much were you paid as chairman of the board, Mr. Marshall?

A. I think \$200 a month. I think I was paid just what my predecessor was paid.

Q. And for how long did you receive that?

A. I think all the time I was chairman of the board until the court proceedings were instituted. I am not sure about that.

[fol. 2913] Q. Can you tell me why that was not set up so as to be reflected in this ten year fee schedule I asked for?

A. I don't know, except that it wasn't a legal fee.

Q. Mr. Marshall, I have not yet before me—I have asked Mr. Jaegerman to return them to court—the minute book of the board of directors' meeting. In that minute book there was a fee of \$15,000 paid to you and some firm of attorneys. Is that correct?

A. Good, Childs, Bobb and Wescott.

Q. You received your proportionate part of that fee?

A. I received a proportion of the fee. That fee was occasioned by litigation which finally went to the United States Supreme Court—

Q. Mr. Marshall, I am not questioning the amount of it—

A. But I want to explain it.

Q. I think it is unnecessary unless his Honor wants to hear it.

A. I want to explain that I wasn't in the litigation all the time, and my recollection is I didn't get half the fee. I only argued the case in the Court of Claims. I got a portion of the fee; what it was I don't remember. That resulted in a recovery of nearly \$200,000 to Fidelity and the cessation of an annual stamp tax which at certain periods would have run at the dollar rate \$25,000 or \$30,000 a year.

Q. Now, the question I am interested in, Mr. Marshall, is this. Why was that not set up on the books as a legal fee until I pointed it out to Mr. Gribben and showed him the minutes of the board of directors' meeting, and then the copies, including my own, were corrected to show it?

A. I have no idea. I certainly have never suggested to any officer that any sort of record should be made on the

books of the company. The officers were elected for that purpose, and they go ahead and make the records.

Q. In 1937 there was another fee of \$5,000 paid to you and a firm of attorneys. Is that correct?

A. I think there was only the one fee. I think Good, Childs, Bobb and Wescott—that was Secretary of War Good's firm—had litigation in Illinois in which, while I participated, I received no fee.

[fol. 2915] Q. The minute book of the board of directors' meeting shows that a fee of \$5,000 was paid to a certain firm and John Marshall.

A. I am very positive, Mr. Palmer, that I only received from Good, Childs, Bobb and Wescott a proportion of the fee they received for the stamp tax. Now, whether that was done in one place or two, I am not sure.

Q. My question is this, Mr. Marshall, that that \$15,000 attorney's fee, which was set up on the minute book of the board of directors—

The Court: Mr. Marshall has answered that question. He says that he doesn't know whether that was paid at one time or two times.

Mr. Palmer: I realize that, your Honor; but—

Mr. Ray: May I ask something here? Weren't the checks brought in here and shown that that \$5,000 fee did not have John Marshall's name on the check? Wasn't that check exhibited to you, Mr. Palmer, here in the courtroom?

Mr. Palmer: I don't think so, Mr. Ray. I don't want to be too certain of my memory, but I am rather positive it was not.

[fol. 2916] Q. The question I want to ask you, Mr. Marshall—dismiss from your mind the \$15,000 fee, as shown by the minute books of the board of directors, made out to the firm of attorneys you mentioned and yourself. Before that time, as shown by the minute book of the board of directors' meeting, there was a fee paid to a firm of attorneys, maybe the same or another one, and to John Marshall, in the amount of \$5,000. That fee is not shown on the books of the company as ever having been paid to you or any part thereof, and is not shown on this report as ever having been paid to you, although it is shown on the minute book of the board of directors. That is what I wanted to direct your attention to.

A. Well, I thought Mr. Gribben testified that he had examined the check and that my name was not on the check.

Q. At the board of directors' meeting the fee bill was submitted and authorized to be paid to this firm of attorneys and you. Is that correct?

A. I saw that minute the other day, yes.

Q. And you were present at that meeting?

[fol. 2917] A. I think the minutes show I retired from the meeting while that was being discussed.

Q. That was the \$15,000 payment. I am talking about the \$5,000.

A. I am just saying, Mr. Palmer, that I have no recollection of ever having participated in any fee with Good, Childs, Bobb and Wescott except the stamp tax fee. What that fee was I don't know. But you will notice from the minutes there were a number of lawyers on the board at that time, including your senior partner, Mr. Koontz, and it seemed to have come as a compromise from Good, Childs, Bobb and Wescott, which was accepted, and I don't think I participated in that negotiation. I know they did the major part of the work and received the major part of the fee.

Mr. Palmer: If your Honor please, I think I will have to defer further questioning along that line until I examine the minute book.

Mr. Huwe: I don't see the necessity for that. An ordinary accountant will make up an account from a check, and it is obvious to anybody. I don't see why there should be any delay on that or any more examination on it, and [fol. 2918] I object to any further questions along that line.

The Court: Overruled. Have you got something else to go ahead with?

Mr. Palmer: Oh, yes, your Honor.

Q. Mr. Marshall, in view of the fact that you received in 1937 a part of that \$15,000 fee, why did you write to the Wheeling Intelligencer in June of this year—

A. 1937, you say?

Q. Beg pardon?

A. You say it was 1937?

Q. Yes.

A. That I received the fee in 1937?

Q. I think that is the correct date. As I say, we will have to check that from the minute book of the board of directors.

Mr. Ray: The schedule here shows it was paid in 1934.

Mr. Palmer: Let's get that.

Mr. Ray: Off the record.

(There was a discussion off the record.)

Mr. Ray: The exhibit that you have in front of you [fol. 2919] shows \$15,000 was paid these people in 1934.

Mr. Palmer:

Q. Mr. Marshall, were you associated or connected with the firm of Covington, Burling, Rublee, Acheson & Shorb in 1937?

A. I was a special partner.

Q. In December of that year they received \$4,612.40, as shown by these figures. Is that correct, to your recollection?

A. They received fees from time to time from Fidelity Investment Association while they were representing it.

Q. In 1938, as shown by this, that same firm received \$2,037.19. Is that correct according to your recollection?

A. That is correct. I imagine it is correct.

Q. All right, sir. In view of that, Mr. Marshall, together with your statement as to having received a part of the \$15,000 fee, the date of which we will set accurately when the minute books of the board of directors are had, do you think that you should have written the Wheeling Intelligencer, to Mr. Ogdén, on Friday, June 20th, 1941, thus: [fol. 2920] "Whether Mr. Fleming or Wheeling attorneys receive fees growing out of this procedure is a matter of no interest to me. Fidelity has been compelled to pay quite a sum of money in the last few years for special legal services, a considerable sum of which has gone to Wheeling attorneys, but I have received none."

A. I think that is a fact.

Q. In the ten year period of 1931 to 1941, Mr. Marshall, this record shows that you received \$4,502.16 legal fees. Is that correct?

A. I assume it is correct. I am not questioning the record.

Q. You are not denying it?

A. Oh, no.

Q. The record shows that including the amount which I previously read to you, with Marshall and Forrer's fees

from 1938 to 1941, there was a total paid to you or to your partners of \$6,004.65. Is that correct?

A. I assume it is.

Q. You have further stated, of course, about receiving a part of the \$15,000 fee. How much did you get of that?

[fol. 2921] A. I cannot remember, Mr. Palmer, but I am satisfied I got less than half the fee, because I only came in the case—the case was started, I think, when I was assistant attorney general, and I only came in the case after it had gone through certain phases and Mr. Good had died.

Q. Did you get as much as \$6,000 of that fee?

A. I cannot remember.

Q. This report also shows, Mr. Marshall, that between 1934 and 1938 the firm of Covington, Burling, Rublee, Acheson & Shorb, in which you were a special partner, received \$17,144.11 in legal fees.

A. \$17,000?

Q. That is what the record shows, Mr. Marshall. I assume it is correct. I didn't make the record, so I can't—

A. Well, whatever the record says I certainly am not questioning.

Mr. T. C. Townsend: What page is that?

Mr. Palmer: It is at the end of the fees of Covington, Burling, Rublee, Acheson & Shorb. This is off the record.

[fol. 2922] (There was a discussion off the record.)

Q. Did you partake of some of the fees that Covington, Burling, Rublee, Acheson & Shorb received during that period of time that I referred to?

A. I think in some instances I did and some I didn't.

Q. Would you be prepared to tell us how much of the \$17,144.11 you did receive?

A. Oh, it would be a guess. I should say perhaps a third of it.

Q. And you still say with reference to all that that you received none of the special fees?

A. Will you read that again, Mr. Palmer?

Q. Yes, sir.

A. All right.

Q. "Fidelity has been compelled to pay quite a sum of money in the last few years for special legal services, a considerable sum of which has gone to Wheeling attorneys, but I have received none."

A. Is there any discrepancy in that?

Q. Don't you call this sum of money you received something?

A. I don't call it in the last few years, occasioned by our [fol. 2923] recent difficulties. I worked very diligently during all this period for Fidelity, and I received no special fees for it, just as I say in that newspaper.

Q. You are attempting, then, to say that within the last year or two you received no special fees? Is that it?

A. Just exactly what I said there.

Q. What did you mean by the word "few"?

A. I meant since Fidelity encountered its difficulties which occasioned this extraordinary expense of nearly \$600,000, as I understand, and I received no fees for any matters growing out of these recent troubles, although I have worked for them very diligently.

Q. Mr. Marshall, that \$600,000 expense which you have spoken of was incurred during the last ten years, as shown by this report.

A. No—

Q. Pardon me. And the troubles you have said began at least as early as 1932, and during that period of time you did receive special fees, didn't you?

A. The troubles—

Q. Will you just answer my question?

[fol. 2924] A. No, I am going to answer it. The troubles I referred to occasioned no litigation. This fee that we received wasn't any trouble; we received it for recovering a stamp tax.

Q. Will you answer my question now, sir?

A. I think I have answered it.

Mr. Palmer: Will the court reporter read it?

The Court: The Court thinks he has answered the question.

Mr. Palmer: May I have the question read for my own information?

(The question was read.)

Mr. Palmer: Will the Court pardon me just a moment till I find in the board of directors' meeting the particular part?

The Court: Well, I assume, Mr. Palmer, that this cross-examination is going to take some little time longer.

Mr. Palmer: Your Honor is correct.

The Court: It is past the noon hour. It is about time for us to adjourn. Unless there is something we particularly [fol. 2925] ought to take up today, I will let it go over.

The Witness: You mean I will have to stay over, your Honor?

The Court: I don't see any other alternative.

The Witness: It works a great hardship on me. I have been here for three weeks waiting for this cross-examination.

The Court: Is there anything else, Mr. Palmer?

Mr. Palmer: Your Honor, I loaned Mr. Ray my booklet of the T. N. E. C., together with the parts of it, and I know he has not had time to read it fully, and if he wants to examine it more fully before I offer those particular parts for the Court's perusal, I will be glad to let him have it.

The Court: Court will adjourn until 9:30 Monday morning.

(At 12:05 o'clock P. M., the hearing was adjourned until 9:30 o'clock A. M., Monday, October 6th, 1941.)

[fol. 2926]

Fifteenth Day

Monday, October 6th, 1941, 9:30 O'Clock A. M.

The hearing was resumed pursuant to adjournment of Saturday.

JOHN MARSHALL, SR., the witness who was testifying at the time of adjournment, resumed the witness stand and continued his testimony as follows:

Cross-examination.

By Mr. Palmer:

Q. Mr. Marshall, over the weekend I have been given the minutes of the stockholders' meetings, the minutes of the board of directors' meetings, and the minutes of the meetings of the executive committee of Fidelity, and I find when I was asking you about two fees in particular, one the \$15,000 and on the \$5,000, that I was mistaken in saying that it was shown by the minutes of the board of director's meeting; it should have been shown by the minutes of the executive committee meeting. Now, with reference to that, Mr. Marshall, on page 90 of the minutes of the meeting of

the executive committee as of August 5th, 1932, it is shown [fol. 2927] here that Sanders, Childs, Bobb and Wescott received or were authorized to receive one fee of \$1,350.58, and immediately following that it is shown that Sanders, Childs, Bobb and Wescott and John Marshall were authorized to receive a fee of \$5,000. Was that fee paid and received, Mr. Marshall?

A. Will you let me see that book?

Q. Surely. (Mr. Palmer hands book to witness.)

Mr. Ray: Your Honor, I again want to object to this because this very matter was up when one of the company employees was on the stand, and he testified about this and testified that regardless of what the minutes showed that the cancelled check did not have Mr. Marshall's name in it. Why should we go into this question when we have had the original records here?

The Court: Overruled.

A. Well, I have no—I have thought about it, Mr. Palmer. I have no further recollection. I do remember that I participated only after this tax refund case got to a certain point, because I think that the record will show that when it was instituted I was an officer of the government and [fol. 2928] couldn't participate. Then my best recollection is I received out of the fee of that firm some proportion, based on the services I had performed. I know that they were in the case for years before I came into it.

By Mr. Palmer:

Q. I am not questioning the propriety of the fee or your propriety in receiving a part of it. What I do want to know, however, is this. The \$5,000 as shown paid to Sanders, Childs, Bobb and Wescott and John Marshall is not shown either by the check by which it was paid or the books of the company to have included you in it, and I want to know if that was by your order?

A. Absolutely not. I never, to the best of my recollection, ever suggested during the 20 years that I have been connected with the company any order or any procedure to be taken with respect to bookkeeping.

Q. Then that would answer my further question as to whether or not you know why it did not appear to have your name on it?

A. I do not know. I still say the best of my recollection is I only participated in one fee.

Q. You are not, of course, questioning the accuracy of the [fol. 2829] minutes as shown here, are you?

A. Oh, every once in a while some meeting will make a mistake in the minutes. Very often they have to be corrected, just as we did the last directors' meeting. I think the check would be the best evidence.

Q. In this particular instance are you questioning that this resolution was passed in that fashion?

A. I have no recollection of such a resolution, and of course I don't question it except I say mistakes are made.

Q. What I want to get is whether you concluded that it was a mistake that your name was included in that fee?

A. I am saying that I have no recollection about it one way or the other.

Q. Mr. Marshall, the minute book of the stockholders' meeting shows that on February 8th, 1928, you were the owner of 220 shares of stock of Fidelity company.

A. I don't remember, Mr. Palmer.

Q. You have no reason to think that that is a mistake of any kind?

A. I have none, but that is 13 years ago, and I cannot tell [fol. 2930] you how much stock I owned in any particular year. I know what I own now.

Q. Now, Mr. Marshall, isn't it further true, as shown by the books, that on February 20th, 1938, a stock dividend of 33⅓ per cent was paid?

A. I think there was a stock dividend, which I testified the other day I thought occurred in the early years of the company.

Q. And isn't it further true that your stock holdings were increasing in the same year, on November 22, 1938, until another stock dividend of 20 per cent was declared?

A. I repeat I cannot remember the amount of the stock dividends or when they were declared. I remember there were several dividends paid in common stock and the other in preferred stock. You understand the purpose of that. That was so the stockholders were not taking their money out of the company, but let it there as an evidence of good faith and to strengthen the contractholders' funds.

Q. And isn't it further true, as shown on page 73 of the minutes of the stockholders' meeting, that on November

[fols. 2931-2938] 30, 1929, a further stock dividend of 50 per cent was declared?

A: It may be, but I repeat I cannot remember the amounts, but I am not questioning it.

Mr. Palmer: If your Honor please, from the minutes of the stockholders' meeting we would like to introduce that part of page 15 and that part of the meeting of November 22, 1928, and that part of the minutes of November 30, 1929 which show the stock dividends.

[fol. 2939] Mr. Palmer:

Q. Mr. Marshall; let me refresh your recollection on that, the other capacities you had at that time. Isn't it true that at the meeting of the board of directors on February 18, 1929, upon motion of Mr. W. H. Bachmann, seconded by Mr. Robert Hazelett, Honorable John Marshall was engaged as special counsel beginning March 4, 1929 at the rate of \$1,000 per year?

[fols. 2940-2941] A. If that record shows it—I didn't think it began that early. I was retained by the company at that time—at one time at \$1,000 a year. Then I might say incidentally, Mr. Palmer, that at about the same period I was retained by another corporation at \$15,000, and I say with the utmost sincerity that during all that period I devoted more time to Fidelity than I did to that company.

Q. My question is—

A. If the record shows that is the \$1,000, I testified the other day I did get a retainer of \$1,000 a year. Whether it began on a certain day in February I don't know—

[fol. 2942] Q. Mr. Marshall, when did you first meet Mr. James Fleming?

A. I think I met him at one time when your senior partner and I were in Washington with Mr. Messick discussing ways and means of effecting a reorganization or improving our situation. Mr. Fleming happened to be [fol. 2943] there on other business, and I met him.

Q. Will you tell me what year that was?

A. Oh, it has been in the last six months, I should say.

Q. And that was in this year, if not within the last six months?

A. Certainly within the last year.

Q. Could you give me any more definite date?

A. Well, if you can remember when the government had its settlement with the Ford Motor Company, that would fix the date, because I understood that was Mr. Fleming's business there, representing Henry and Edsel Ford.

Mr. T. C. Townsend: That was within the past ninety days.

A. I mean earlier—not the final settlement, but the situation—when conversations were being held and accord attempted to be reached.

Mr. Palmer:

Q. Mr. Marshall, when did you first meet Mr. Fleming to discuss with him the problems of Fidelity?

A. Well, that was some time later. Mr. Messick advised me that Mr. Fleming had had considerable experience [fol. 2944] with reorganizations, and that he would be a valuable man if we could get him interested to work on our problems; and afterwards I met him. Again I can't remember the date.

Q. Was it before or after the state court receivership proceedings were instituted?

A. I think my meeting with him was before the state court receivership.

Q. Before the state court receivership. Mr. Marshall, I don't know whether you were here present when Mr. Harlan Justice testified. Were you?

A. No, I was not.

Q. Mr. Justice testified in substance—and I would rather counsel or the Court would correct me if I deviate materially from the matter I am about to relate—that Mr. James Fleming, at a meeting in Chicago at which there were present a number of securities and banking commissioners of various states, that Mr. Fleming appeared before that meeting, and as my recollection recalls Mr. Harlan Justice's testimony he said that Mr. Fleming had told that meeting that you had asked him to represent you, to look after your [fol. 2945] interests in Fidelity, because you were its lawyer for one of the largest stockholders. Now—

A. Well, I have no reason to question the veracity of Mr. Fleming. I don't know what he said or what Mr.

Justice said he said, but I certainly have on various occasions expressed my gratitude to him and my appreciation of what he was trying to do. I don't think that I stressed the fact that I was the largest stock holder, but I stressed my interest in this whole general situation, and I think Mr. Fleming has said to others that that was one of the reasons he had become interested on my account. Those things sometimes happen, you know; people get to like each other and do things for each other.

Q. Yes. What I want to arrive at, Mr. Marshall, is when the time came, either before or after the state receivership proceedings were instituted, Mr. Fleming undertook either formally or informally to look after this for you or to help the company out, as you have indicated.

A. Well, I stated it was before the state receivership, because I am thinking—

[fol. 2946] Q. Pardon?

A. I say to the best of my recollection my first—not only my first but my second meeting with Mr. Fleming came before the state receivership proceedings—

Mr. Ray: Your Honor, I want to register an objection to this, because the note I made when Mr. Justice testified was that Mr. Fleming said he had been brought in by the stockholders, principally Mr. Marshall.

Mr. Palmer: Mr. Ray, I asked counsel to correct me if my memory was mistaken.

The Court: It is best to be sure before you quote what has gone into the record, to be sure you are right.

Mr. Palmer: That is why I asked counsel and the Court to correct me. I didn't like to rely on my memory.

The Court: I say it is best not to rely on somebody else to correct you, but to be sure you are right before you ask the question.

Mr. Palmer: If your Honor please, it has been impossible to get a transcript in this hearing. I have to rely on my memory for these things.

Q. Mr. Marshall, when did you and Mr. Fleming first [fol. 2947] begin the discussion that it might be advantageous or for the best interests of Fidelity to have a proceeding instituted in Federal Court?

A. I think it was after it became evident that there were a number of receiverships springing up and after I learned

for the first time the attitude of Securities and Exchange Commission.

Q. Then you would say—I think that letter of the Securities and Exchange Commission was dated May 9th. Isn't that correct?

A. I don't remember.

Q. I am again relying upon my somewhat fallible memory. And it was after that date that you and Mr. Fleming first began discussing federal court proceedings. Am I correct in that?

A. I think so. Your senior partner could give you the full information, because he participated in some of these discussions.

The Court: Are you speaking of Arthur Koontz?

A. I am.

Mr. Reinhardt: Your Honor, May 9th is the date of the letter sent by Mr. Healy to Mr. Marshall, which has [fol. 2948] loosely been referred to as a letter by the Securities and Exchange Commission.

A. Well, I think I stated in my newspaper article it was one of the commissioners.

Q. But the letter that both you and Mr. Palmer have been talking about is the letter sent by Mr. Healy to you?

A. That is right.

Q. Not a letter of the Commission?

A. Oh, I never said that—in fact, I tried to explain that I considered it more or less of a personal letter rather than a letter from the Commission, but I am simply saying that the letter disclosed to me the attitude.

Mr. Palmer:

Q. Now, Mr. Marshall, up until you received that letter from Commissioner Healy, you had been of the opinion that state court proceedings were better than federal proceedings? Isn't that true?

A. Mr. Palmer, I think the record—you have been studying the minute books over Sunday—the whole record shows that with respect to this reorganization, either without court proceedings or with court proceedings, was entrusted [fol. 2949] by the directors to Mr. Koontz, and I followed his recommendations. Now, when Mr. Koontz failed to come in response to my invitation to the Pittsburgh meeting

and the discussion there developed certain facts coupled with my own information as contained in Mr. Healy's letter, I changed my attitude.

Mr. Palmer: Will you read the witness my question, please, and let's see if he will answer it.

(The question was read.)

Q. I think you implied the answer to that question is yes. Is that right, Mr. Marshall?

A. I have answered the question. I don't think I can say, in fairness, without explaining, that I favored it. I voted for it on the recommendation of counsel who had been entrusted with the matter, but without full information from said counsel.

Q. Now, let me see if I understand that. You relied upon the judgment of Mr. Arthur Koontz and his firm—

A. I saw no—I don't want to imply that I was just blindly following what Mr. Koontz said, although I had the highest regards for him and we had been friends, [fol. 2950] as I supposed, for twenty years; but I saw no reason at the time to take a different course than the one he suggested. I was heartily in accord with him, and the minutes show that the directors voted that way unanimously.

Q. Mr. Koontz had not been a director of the company from the middle part of 1940 up until that time, had he?

A. No, but he had been counsel acting for Fidelity before the Commission and before the state departments as well.

Q. But you relied to a large extent upon his judgment and recommendation?

A. I think I have stated fairly just my situation in that respect.

Q. And in the meeting of April 7th, you, I believe, made a motion that the firm of Koontz & Koontz be appointed attorneys for the debtor in the state court proceedings?

A. That is correct. I had every confidence in them.

Q. Mr. Marshall, isn't it true, if you had seen—or is it not true—that you had seen the letter of March 25th written by the State Auditor to Mr. Koontz?

[fol. 2951] Have you seen the copy of that introduced in evidence here?

A. No, I have not.

Mr. Palmer: Will you get me Exhibit 94, please, Mr. Price?

(Exhibit 94 was handed to the witness.)

A. When I first started to read that letter I thought I had. I am not sure, Mr. Palmer, but I do know this, that I was advised that Mr. Sims had been in conference with the Commission, and I had assumed that all the parties were trying to work out the best solution.

Q. If you did not see a copy of that letter, at least you had been given, by information, the substance of the contents thereof? Is that true, Mr. Marshall?

A. I have a recollection that Mr. Koontz wrote me a letter once from Mr. Sims' own office some time, which I regarded as a very serious—which I thought was a very serious letter; but I really do not recall that it was suggested by Mr. Sims that Mr. Koontz explore the—as I think that letter indicates—the possibilities of reorganization, although I have no reason to doubt it. If Mr. Koontz, for [fol-2952] example, would say that he had showed me the letter, I would say all right, but I really have no recollection of that part of the letter.

Q. Mr. Marshall, Mr. Koontz became a director of the company in the early part of 1932? Is that your recollection?

A. I don't remember. I know he has been on a good while.

Q. I think the board of directors' and minutes of the executive committee do not show his name appearing on them before March or April, 1932, and then on that meeting of July 9th, and perhaps one meeting before it shows his appearance. Would that be substantially correct?

Mr. Ray: Your Honor, if I am not mistaken, he brought out Mr. Koontz's tenure on the board by Mr. Risley, and, I think he brought out the same question by another witness. It should be in by this time.

Mr. Palmer: You are correct, Mr. Ray, but I want to refresh Mr. Marshall's recollection as to the tenure of Mr. Koontz.

The Court: What bearing does that have on the inquiry?

[fol. 2953] Mr. Palmer: Because I am going to ask him certain things based on that recollection.

The Court: On his recollection of when Arthur Koontz became a director?

Mr. Palmer: Yes, not specifically on that but—

The Court: It seems to me you can just assume that without asking him those questions, because it is already clearly in evidence, and the minutes would show when it occurred.

Mr. Palmer: After Mr. Koontz came on the board of directors, do you know at whose instance that was, Mr. Marshall—were you instrumental?

A. Well, I have just been sort of smiling, Mr. Palmer. I think that I have heard that he had about the same sentiments with respect to Fidelity and me that you say Mr. Fleming did, and I have always appreciated it.

Q. He became interested in it because of his personal friendship with you?

A. That is what I have always understood, and on many occasions expressed and tried to show my appreciation as well.

Q. And to your knowledge he worked long and diligently [fol. 2954] for Fidelity?

A. I had always assumed so.

Q. Well, you had knowledge of a large amount of that, without having to assume it, did you not, Mr. Marshall?

A. I don't see what my feelings then or now with respect to Mr. Koontz—I would just rather not discuss that, please.

Q. It is a question of your knowledge—

A. I know Mr. Koontz put in a great deal of time for Fidelity, if that is what you mean.

Q. And rendered some very valuable service for a good many years?

A. He was very faithful in his attendance at the meetings and always evinced a great interest in Fidelity.

(There was a discussion off the record.)

Q. Mr. Marshall, how familiar were you with the difficulties of Fidelity from the first of January up through the 7th or 8th of April, 1941?

A. This year?

Q. Yes.

A. Well, I tried to be familiar with them. It now de [fol. 2955] velops there were several things I didn't know.

Q. Such as, Mr. Marshall?

A. Well, principally the information I received from Mr. Healy's letter—Mr. Healy's letter.

Q. You didn't know of the things in Mr. Healy's letter until you received it? Is that correct?

A. I had understood that someone—I want to be very meticulous—I heard people talking about what the Commission said. I have always assumed that the Commission acts only when the Commission does something, but my information definitely was that someone in the Commission had suggested that we needed—and I remember it distinctly because of the expression—that we needed the umbrella of the court, but it was only when Commissioner Healy wrote me that I understood that it wasn't just any old court, that they had a court in mind.

Q. You are speaking of that part of Mr. Healy's letter which the Court has read in evidence, and no other part?

A. Certainly. No matter how you may consider the letter, I got that impression.

Q. Mr. Marshall, isn't it true that after you received Mr. [fol. 2956] Healy's letter you wrote back to him?

A. I think I did. I am sure you have all those letters in your files, or Koontz & Koontz.

Q. Yes, sir, Mr. Marshall, and I might explain to the Court—I say this in fairness to Mr. Marshall and myself—in the hall of the courtroom, after court adjourned on Friday, and after I had stated to the Court that I had not seen the original letter or a copy thereof of Mr. Healy or his reply, that Mr. Arthur Koontz deemed those letters confidential, Mr. Marshall told me that they were letters from general counsel to field counsel, and if I had not seen them I should see them; so with that authorization from Mr. Marshall I have since seen that letter and Mr. Marshall's reply thereto. Until then I had not seen the letter, I want to assure the Court.

The Witness: I don't think, Mr. Palmer, that is quite accurate. I didn't say you should see them. I asked you if you had seen them. You said you had only read parts of them, because you thought they were confidential.

Mr. Palmer: You further said if I had not seen them you [fol. 2957] wondered why I had not seen them.

The Witness: You told me you had seen them.

Mr. Palmer: Didn't I tell you, Mr. Marshall, in the hall of the courtroom, when you asked me why I told the Court

I had not seen the letters, that Mr. Koontz had shown me a part of one letter and the rest was confidential?

The Witness: No, you didn't say Mr. Koontz had shown them to you; you said you had seen a part of them.

Mr. Palmer: At any rate, if the Court please, I had not seen this other letter until after that statement was made that it was from general counsel to field counsel.

The Witness: That is not entirely accurate. That letter wasn't sent around to counsel promiscuously. We have lots of counsel. That letter was sent to Mr. Koontz because Mr. Koontz was aware of what I was doing in this matter and because he had been entrusted particularly by this company with this phase of our situation.

The Court: The Court is entirely in the dark about what letters you are talking about. You referred to one letter, [fol. 2958] the letter from Mr. Healy to Mr. Marshall. I understood Mr. Palmer had never seen that, but had been told something about it which afterwards proved to have been false. If there is any other letter I am in the dark.

The Witness: If it please the Court, he also asked if I had not written a letter to Commissioner Healy to get this response.

Mr. Palmer: No, I am talking about another letter. After Mr. Healy wrote you you wrote a reply to Mr. Healy?

The Witness: Well, I wrote first a letter to Mr. Healy which occasioned this letter to me.

Mr. Palmer: Well, I have never seen that, Mr. Marshall. I don't know that Mr. Koontz even has a copy of it. If you would like to produce that letter I would be very glad to have it.

The Witness: I have not wanted to produce any of this correspondence, because I felt it was personal.

Mr. Palmer: I do now speak of a letter, your Honor, which Mr. Marshall said he wrote in reply to Mr. Healy, and on the subject which the Court has read in evidence.

The Court: What is the question about that letter?

[fols. 2959-2976] Mr. Palmer: I wanted to explain to the Court why I had not seen them. My question, Mr. Marshall, is, In your letter of May 10th to Mr. Healy did you not say that while you did not know of the attitude of the Securities and Exchange Commission; or words to that effect, and I would like to have your copy of the letter produced so that I could quote it accurately—that if you had

had that knowledge you would still have approved the other proceeding?

A. I don't remember that.

Q. Beg pardon?

A. I don't remember saying that.

Q. Will you produce your copy of that letter, please, Mr. Marshall?

Mr. Ray: Have you got a copy of it?

Mr. Palmer: I don't know.

Mr. Ray: Where are we getting—

The Court: Do you object?

Mr. Ray: I do.

The Court: Sustained.

[fol. 2977] Q. Mr. Marshall, did you play a large part in selecting those who became members of the board of directors, in helping to ask prominent people to serve upon the board of directors?

Mr. Huwe: Your Honor, I object to that because we just went into it just last Saturday, and I think that has been fully covered.

Mr. Ray: With Mr. Risley and with another witness.

The Court: I am going to permit one answer here, but I am not going to permit a lot of detail to be asked this witness that will simply cumber the record. He may reply whether he did or not, and then let's leave it.

A. I think I can answer in a sentence. When I first came on the board it was entirely a West Virginia proposition. After we launched out into other states frequently I would be the only West Virginian that knew people in those states, and I did in some instances, many instances, secure friends that I thought would be valuable directors for Fidelity to go on the board. Many other valuable directors I had nothing to do with.

[fols. 2978-2992] Mr. Palmer:

Q. Mr. Marshall, isn't it true that you knew that when state court proceedings were to be instituted the Auditor of West Virginia was going to ask the other states to appoint receivers in those states to freeze the funds there?

Mr. T. C. Townsend: We object. That has been gone into many, many times.

The Court: I don't know whether this witness has been asked the question or not.

Mr. T. C. Townsend: Well, probably not by this witness.

The Court: Overruled.

A. I understood that Mr. Sims was going to seek injunctions, and I had some assurances that he would very probably be successful.

Mr. Palmer:

Q. My question is whether you knew that Mr. Sims would wire to other states and ask them to appoint—

A. Yes, yes. I believed in this proceeding at first.

Q. Sir?

A. I was heartily in favor of the state receivership at first.

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[fol. 2993] Mr. Palmer:

Q. Mr. Marshall, what, if any, part did you play with reference to having the meeting in Pittsburgh of June 3rd called?

A. I approved of it.

Q. It was discussed with you, I understand; from your answer, before it was called?

A. Yes, sir, discussed where it should be held—where the most convenient place would be.

Q. And who so discussed it with you?

[fol. 2994] A. I think it was Mr. Messick; I would not be certain.

Q. How long prior to the meeting?

A. I don't remember that.

Q. Would it be longer than a week?

A. I don't remember.

Q. Would it be longer than a month?

A. Oh, no.

Q. Mr. Marshall, on September 17, 1941, did you know that Mr. A. L. King was summoned as a witness in this present proceeding?

A. I heard he was and testified.

Q: Did you meet him in the hall and request that he attend a board of directors' meeting to be held that day?

A. Yes, sir.

Q: Did you and Mr. Fleming further meet with him and have an extended discussion—more or less extended—in which you asked him to attend the board of directors' meeting?

A. I first spoke to him and asked him if he had resigned as both secretary and director, and he said he had resigned [fols. 2995-2998] as both; but of course, his resignation had never been accepted, and I felt he was eligible, and I found that he was taking a position that I couldn't understand, and I asked him to talk over the situation with Mr. Fleming, that there must be some misunderstanding. He said we had treated Mr. Koontz improperly and he wasn't going to attend the meeting.

[fol. 2999] Mr. Palmer:

Q: Mr. Marshall, can you tell us, if you know, why the tellers did not set forth the names of the persons present at the meeting of October 3, 1941, together with the shares of stock they represented, when, so far as I can discover, it was the first meeting of stockholders for many years at which said practice was not followed?

A. I don't know why. I know that it took almost all morning to do what they did, and I know I appointed on that committee three employees of the company, two of whom had acted at previous meetings for that same duty.

Mr. Palmer: If your Honor please, it is not shown by the minutes of the meeting of the board of directors' or the stockholders' meeting what persons were present and what stock was represented other than Mr. Philip D. Paull acting for the tellers' committee reported that of a total of 10,233 shares of stock 9,987 were present, by proxy or trustee, and such representation constituted a quorum.

The Witness: Mr. Palmer, the tellers' report is in there and shows the stock represented in person, the stock represented by trustee, and the whole report. It does show [fol. 3000] that.

Mr. Palmer: That is fine. Will you show that to me?

Mr. Ray: It is right at the end of the minutes.

Mr. Palmer: The part shown to me has already been read in evidence, which merely shows preferred stock, number of shares, common stock, number of shares, but does not state the names. Now, my question to Mr. Marshall was as to why the names were not set forth, and my remarks which I was about to direct to the Court when I was interrupted, were that it is not shown who was present representing which stock, so that it can be checked whether that stock was correctly represented and correctly there, and it is the first time in at least a good many years at which that practice was not followed.

The Court: Well, the witness has advised me that a committee was appointed for that purpose. Do you know why they did not detail it?

The Witness: I do not know, unless it was because of the time element, your Honor. We were told that this Court wanted that report in that day, and I didn't even wait for lunch. Just as soon as I could get the material [fol. 3001] I started out.

[fol. 3002] Mr. Palmer:

Q. Mr. Marshall, it is true, is it not, that as general counsel of Fidelity you passed upon and approved all of the fees paid to Mr. Arthur B. Koontz or the firm of Koontz & Koontz or their predecessors for legal services rendered?

A. I don't know about that. I was supposed to, but I don't know.

Q. You were supposed to.

A. I say our firm was supposed to.

Q. So far as you know it was done in the proper manner?

A. I don't know. I mean I would have no way of knowing. It is conceivable that a fee might be paid by an officer without my approval. I have known it to be done.

[fol. 3003] Q. In connection with Mr. Koontz?

A. Not in connection with Mr. Koontz.

Q. So far as you know, you never raised any objection to any fees paid Mr. Koontz?

A. I never raised any objection. I have never made any check whether I approved. In a great many cases I tried to get lawyers to reduce their bills, and if I finally ap-

proved it that was because I was unsuccessful. I tried to be conscientious.

Q. I am speaking only about the Koontz fees. Have you discovered in your notes any place where you raised any objection to them at any time?

A. No fee ever rendered by Koontz & Koontz that I objected to.

Q. And when it was approved by a board of directors' meeting or executive committee meeting you never raised any objection at any time?

A. I am sure that I never did.

Q. And you were familiar personally at least to a large extent with the legal services that Koontz & Koontz were rendering?

[fols. 3004-3012] Mr. T. C. Townsend: We object, your Honor. That has all been gone into very thoroughly.

The Court: Overruled.

A. I kept very closely in touch with Mr. Koontz.

Mr. Palmer:

Q. So that in connection with the bills you had a general idea of the work that had been done by Mr. Koontz and his firm?

A. The ones I approved.

Q. And you stated that so far as you know you raised no objection to any of them?

A. I never raised an objection, I am positive, to any bill that was ever presented to me from Koontz & Koontz.

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[fol. 3013] JOHN MARSHALL, recalled, testified as follows:

Q. It is true, as shown by the minutes of the corporation, that your son, John Marshall, Jr., is and has been a director for some period of time, is it not?

A. That's correct.

Q. It is also true, is it not, Mr. Marshall, that immediately following the appointment of State Court receivers, your son, John Marshall, Jr., was dismissed as an employee of the State Court receiver?

A. That is correct.

Q. Mr. Marshall, is it a fact that after Mr. Messick became chairman of the board, he placed much more substan-

tial duties upon your son, John Marshall, Jr., than had the officer theretofore—much more substantial and responsible?

[fol. 3014] A. The only—I can't answer definitely to that. I know that Mr. Messick once undertook a survey of our securities and so forth, and my son—

Mr. T. C. Townsend: Excuse me. I want to get that question, if the Court will pardon me.

(The question was read.)

Mr. T. C. Townsend: I can't see where it is leading to—I can't see where it is leading to anything material.

The Court: Let it be answered.

A. I know that Mr. Messick undertook to make a survey, which he testified about here recently, of our portfolio, and how he consulted experts and bankers and so forth, and in that study he had my son, who had trained along that line with J. P. Morgan & Company and had majored in economics in college, work on that situation for several months. I know with respect to that, he added that responsibility to him. I think he also asked him to make surveys or ascertain if expenses couldn't be reduced. I think he did that.

Q. Those had been more substantial duties and more important duties than your son had theretofore been performing, is that correct?

[fol. 3015] A. I can't say about that.

Q. Mr. Marshall, did the fact that Mr. Messick had seemed to realize the capabilities of your son, after he had been discharged by the State Court receivers play any part in your change of opinion from wanting it in the State Court to wanting it in the Federal Court?

A. Not at all.

Q. Mr. Marshall, after the meeting in Pittsburgh, was there a discussion had that Mr. Fleming was to present as the attorney for the debtor the petition to the Southern District Court of West Virginia?

Mr. Lauritzen: Mr. Steussy has come here, the witness we expect to introduce. I want to ask counsel if there is any objection to having him in here?

Mr. Ray: He might wait outside like the other witnesses did.

Mr. Palmer: Is there a question there?

(The question of Mr. Palmer was read.)

A. I don't know that that was specifically discussed. As I understood it, the institution of this proceeding was authorized, and not only my understanding was—but I arranged for them to see particularly my brother in south-[fols. 3016-3020] ern West Virginia, to discuss the whole situation with him. I don't think a meeting was needed. I was general counsel. I could approve of Mr. Fleming acting without any discussion of the board of directors. I am satisfied that the minutes will not show that that specific action was taken.

Q. My question was as to whether there was a discussion at the meeting in the sense that Mr. Fleming was to be the attorney to present the petition for the debtor in this Court?

A. I don't think so.

Q. Now, was there any discussion, Mr. Marshall, at that meeting that Mr. Fleming and Mr. Messick were to be employed by the trustee to aid the trustee in reorganization?

A. I am certain that wasn't discussed, although Mr. Messick, you understand, had been appointed by the board of directors the chairman of the Committee on Reorganization with power to select persons, and I knew he had asked Mr. Fleming to be associated with them. The question that they were to be employed by the trustee I am sure wasn't discussed.

[fol. 3021] Q. Mr. Marshall, in your letter to Judge Healy of May 10th, did you state to him these words: (Reading) "I was advised that as soon as the insurance commissioner of West Virginia learned our plan had not been approved by the Securities and Exchange Commission, he took steps which subsequently resulted in the appointment of receivers. I think it only fair to say, however, Judge Healy, that if I had had a choice in the matter I would have preferred the course which has been taken." I asked Mr. Marshall [fol. 3022] about that in substance without having the exact words, and I submitted that at that time, if he had answered, his answer would be Yes. I wanted the exact words, your Honor.

The Court: I don't recall any question this morning or ruling or why it was made, but I will permit the witness to answer.

A. I assume that that is correct. The record bears out the fact that I preferred the State Court. That is the reason

I voted for it in the first meeting of the board of directors, on the representations and information I had at that time.

Q. And the following sentence was this, Mr. Marshall:

Mr. Ray: How far is he going with this letter?

The Court: I don't know.

The Witness: It is a private letter.

Mr. Ray: I object. If he is going to read the letter—

The Court: Let's see what it says.

Mr. Palmer: The following sentence was this: (reading)
 "I have reasons for this which I do not care to put in writing. If the matter is of any interest to you, and we are being confronted by this situation, I would deem it a favor to be permitted to explain them."

[fol. 3023] A. I remember saying something like that.

Mr. Palmer: All right, sir.

Mr. Townsend: Read the answer.

(The answer was read.)

Mr. Ray: May I see that? (Referring to paper)

Mr. Palmer: I would prefer not to, because the Court has deemed that some of those letters are confidential—unless Mr. Marshall says he would be glad to. Otherwise I would not like to show him the letter.

The Court: The Court's ruling on the confidential nature was due entirely to Mr. Marshall.

Mr. Palmer: Yes.

The Court: It seems that it wasn't so confidential after all, if you have it in your file.

Mr. Palmer: If Mr. Marshall desires that I show it to Mr. Ray—

The Witness: I prefer not to. I regarded—I wasn't writing the Commission; I was writing the Commissioner. I regarded the whole file as confidential. On the other hand, the firm of Koontz & Koontz had been appointed by the directors to represent us in this matter, and I felt they [fol. 3024] should have the benefit of any information that I had.

Mr. Palmer: Then with that, your Honor, I think the only pertinent part, which I have read, would be the only part which should be given to Mr. Ray.

Mr. Ray: I don't think Mr. Palmer should be permitted to bring a letter that counsel haven't seen, read part of it

in the record and ask questions about it without letting counsel see it. I therefore move that the questions bearing on this letter be stricken from the record.

The Court: The privilege is Mr. Marshall's. If he wants the letter exhibited to counsel, it should be. If he doesn't, it shouldn't.

Mr. Palmer: Let the record show I have no objection to it, but believe it is a privilege with Mr. Marshall.

The Witness: If Mr. Palmer is to read parts of it, there is no reason why Mr. Ray, representing the debtor, should not see it.

Mr. Palmer: Let the record show that Mr. Palmer has now presented to Mr. Ray the papers about which we are speaking.

The Witness: I think in fairness I ought to say, the reason I didn't care to put the matter in writing—certainly [fol. 3025] it has no relation to this Court, because since that time—I never knew—I never did see Judge Moore until I came in this Court room. It was outside—it had nothing to do with this Court is the reason I have for my actions.

Mr. Ray: May Mr. Marshall be excused from the witness stand for a moment while I ask him a question about this?

The Court: All right.

(Witness leaves stand and confers with Mr. Ray.)

Mr. Palmer: Your Honor, I withdraw until Mr. Ray wants to ask about this letter, and then I will resume.

The Court: All right.

(Witness resumes stand.)

Mr. Ray: Mr. Marshall, just now when you withdrew from the stand I asked if you had any objection to filing two sentences in this letter of May 10th, and you told me you did not.

A. I understood they were really parts of what had been read.

Mr. Ray:

Q. The sentence immediately preceding the one which Mr. Palmer read. May I read them into the record?

A. I have no objection.

[fol. 3026] Mr. Ray: (Reading:) "I have carefully read the paragraphs of your letter referring to the efforts of

Fidelity and the Commission to reach an accord. The only thing I did not understand was that the Commission had coupled with its refusal to approve the plan of reorganization submitted the further recommendation that the Association resort to the reorganization procedure of Chapter 10 of the Bankruptcy Act. In any event, the Association had no choice of decision."

Q. Mr. Marshall, are those the two sentences which I have just read in the paragraph immediately preceding the sentence which Mr. Palmer read?

A. That is my understanding.

Mr. Palmer: If your Honor please, I have something that I would like to ask the Court, but I hesitate greatly to ask to be permitted to go into the record. The Court has on several occasions reprimanded me as counsel for asking for the production of a letter which the Court felt, after a comparison of a newspaper article or letter, was improper to be brought in or even if proper, it was of such relative unimportance to raise such a furor about, and I have pro-[fol. 3027] ceeded in accordance with the Court's reprimand in that respect. I felt somewhat embarrassed about it. Your Honor, having had this letter before me for the first time where I could compare the two, there is to my mind a distinction which I would like to be permitted to point out to the Court and to ask Mr. Marshall about, if the Court doesn't feel that counsel is being improper to present this matter that the Court has ruled so conclusively about.

The Court: Let's see what it is.

Mr. Palmer: I would first like to read, your Honor, the pertinent part of the letter of Mr. Healy—

Mr. Ray: That is already in the record.

Mr. Palmer: I am just reading it to the Court.

(There was a discussion off the record.)

Mr. Palmer: My distinction is this, your Honor, that in one, the Commission doubts as a practical matter whether any plan could be put into effect without the Chapter 10 proceeding, and said it would not approve of any in any other Court which didn't come up to the standards of Chapter 10. The letter of Mr. Marshall says that the Commission flatly says, no matter what happens, it wouldn't approve of any plan that went through unless a Federal Court [fols 3028-3039] had done it. Your Honor may be correct

that I am splitting the northwest corner from the north side of a hair from the south. I do deem it a substantial difference; as Mr. Marshall put in his letter, it would leave an alternative for the Federal Court proceeding, whereas the Commission, in stating its tentative position, would leave a way open for the State Court proceedings that were then going on.

The Court: That distinction seems to me so trivial that it is practically non-existent, and I feel that if I had been in Mr. Marshall's place, I would have drawn the same conclusions from the letter he drew and expressed in his letter. That's why I have said what I have on this record about that letter.

Mr. Palmer: Your Honor, I am sorry I misinterpreted. I thought there was a substantial difference or I would not have raised the question. In view of the Court's ruling, I will make no more mention of the matter.

[fols. 3040-3046] Q. Didn't you have conferences with Mr. Messick and Latta in February 1941 about these plans?

A. I can't remember the dates. I remember one further fact that Mr. Latta was recommended by the Lincoln Life Insurance Company.

Q. Of Fort Wayne, Indiana?

A. Yes. I think they gave a number of names of persons that would seem to fill this specification, and Mr. Latta seemed to be the highest of any recommended.

Q. What special qualifications did he possess?

A. Well, he had been in reorganization matters and was acquainted with the same type of business that we were in and in the insurance business that we would go into.

[fol. 3047] HENRY M. STEUSSY, called as a witness, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Lauritzen:

Q. You are Mr. Henry M. Steussy?

A. That is right.

Q. (Spelling) S-T-E-U-S-S-Y?

A. Yes.

Q. Where do you live?

A. At Milwaukee, Wisconsin.

Q. How old a man are you?

A. Forty-eight.

Q. Were you formerly connected with the Fidelity Assurance Association?

A. Fidelity Investment Association.

[fol. 3048] Q. Now known as Fidelity Assurance Association?

A. That is correct.

Q. When did you first become connected with Fidelity?

A. April 7th 1931.

Q. Prior to becoming connected with Fidelity, what was your business?

A. I was with the Provident Life Insurance of Philadelphia.

Q. In what capacity?

A. As an agent.

Q. Had you enjoyed some success in that line of endeavor?

A. I did.

Q. Now, Mr. Steussy, will you just relate in your own words, if you will, how you first heard about Fidelity and what it was that induced you to take up work with it?

Mr. Ray: I object. That cannot be material.

The Court: Sustained.

Mr. Lauritzen: Mr. Steussy, when you became associated with Fidelity, in what capacity was it?

A. I was the manager of the Wisconsin office.

Q. That meant that you had charge of the Wisconsin salesmen?

[fol. 3049] A. That's correct.

Q. Now, through whom did you become associated with Fidelity?

A. Mr. J. H. Pulfer, who was the assistant supervisor of the company.

Q. And was it Mr. Pulfer that explained Fidelity's plan to you?

A. That is correct.

Q. Was there anything in particular about Fidelity's plan that attracted you to it?

Mr. Ray: Your Honor, I think that is immaterial.

The Court: Sustained.

Mr. Palmer: If your Honor please, if the Court will allow another counsel to be heard on that objection, I believe the form of the question is improper, but would it not be material as to what Mr. Pulfer or another officer of the company told him about Fidelity that made him decide to go with it, on the question of whether or not, if it would be reorganized, other salesmen could be had upon that same proposition, or whether that proposition would be one that would now be impossible to comply with or whether that particular explanation by the company was an erroneous one.

[fol. 3050] The Court: No. A reorganization wouldn't have any bearing on the old setup. That is, what I mean by that is that if there are objectionable features about the representations made to salesmen by the old company, they certainly wouldn't be carried over into any reorganization.

Mr. Palmer: That was my point, your Honor. Unless we know what they were, it would be impossible to say that they might not be carried over.

Mr. Lauritzen: It is really unimportant.

The Court: Then why ask the question.

Mr. Lauritzen: Mr. Steussy, did you become aware that the company operated under a deposit law in Wisconsin?

A. Very definitely.

Q. Was that one of the reasons you were attracted to it?

A. I didn't go with them until I had full time to check it up and satisfy myself as to the safety of the sale of the contracts to our Wisconsin people.

Q. Is it a fair statement that that was the chief reason why you took up—

The Court: Mr. Lauritzen, I sustained the objection to these questions, and while counsel is not objecting to it now, I think that I ought in my own motion prevent you from asking the question. It is immaterial why this witness went [fol. 3051] with Fidelity. That certainly is an understandable ruling.

Mr. Lauritzen: I think the materiality of it will be evident in a moment. Now, what was the status of Fidelity in Wisconsin as to total outstanding liabilities when you came with it?

Mr. Ray: If he knows, your Honor.

Mr. Lauritzen:

Q. If you know.

Mr. Ray: And if he has had charge of the books and records which would show that his information is accurate. I don't think he should guess at it.

Mr. Lauritzen: Strike the question.

Q. Mr. Steussy, when you took up your association with Fidelity, was information given to you as to the total Wisconsin liability?

A. I was told there was less than twenty thousand dollars.

Q. Did you later ascertain that to be a fact by reports that you received or copies of reports sent to the Banking Commission of Wisconsin?

A. That is correct.

Q. When you first took hold of the Wisconsin office, how many salesmen did you have?

[fol. 3052] A. Two.

Q. Now, tell us what you did with respect to recruiting a sales force; how you went about it and what results you obtained.

Mr. Ray: Your Honor, I submit that that is immaterial to the issue in this case.

The Court: Point out its relevancy.

Mr. Lauritzen: The point is that Mr. Steuss was in charge of developing one of Fidelity's largest and most successful sales forces, and with that as a background, his testimony will certainly have a great deal more significance than if he were just some stranger to this entire proceeding.

Mr. Palmer: May I suggest that the qualification of the witness is to show the Court his background of experience and learning upon which later questions would be based.

Mr. Ray: Questions based upon the issue in the case?

Mr. Palmer: In other words, if you put a doctor on the witness stand—

Mr. T. C. Townsend: You ask him about a medical proposition.

Mr. Palmer: If you want to ask this witness about sales [fol. 3053] later of a company to be reorganized, then you would have to ask him about what his experience has been in the selling field and how he arrived at it. It is a qualifying question, your Honor.

The Court: Do I understand that this witness is an expert witness, or does he know facts?

Mr. Lauritzen: I would say he would come in both categories. If the gentlemen will just let me develop his connection with this company. I don't think it is fair.

The Court: The thing I am interested in, is whether your line of examination is pertinent to the case. If it is, we will permit you to go along with it.

Mr. Lauritzen: This witness has had a background of experience with this company of a great many years, and he was a high executive. Surely he is going to be a witness that this Court is going to listen to with respect to expressing opinions on what the future of this company may be, or what can be done or could be done.

The Court: Are you going to use this witness as an expert witness or a witness to facts?

Mr. Lauritzen: I think he would be a witness to facts.

The Court: Then how are the facts pertinent?

[fol. 3054] Mr. Lauritzen: As to his contact with this company?

The Court: Yes.

Mr. Lauritzen: Why, just this.

The Court: You can't bring in every salesman all over the United States and show that he was a salesman for this company.

Mr. Lauritzen: This man is a managing director of the company in charge of sales in a large area, in the largest office they had in the company.

The Court: I will sustain the objection to the question.

Mr. Lauritzen:

Q. Mr. Steussy, were you successful in recruiting a large number of salesmen for Fidelity and did you do it?

Mr. Ray: Your Honor, I submit that is irrelevant.

The Court: Sustained. I don't care to argue. I have ruled.

Mr. Lauritzen: If the Court please, I will offer to prove that Mr. Steussy built up a very large force of salesmen in the State of Wisconsin through his efforts in recruiting them; that he became extremely familiar with that work and was extremely able in that work, as demonstrated by [fol. 3055] his record with Fidelity. I don't suppose anyone will dispute it that by 1938 he had 225 men working

for him in the State of Wisconsin. Now, if the Court will permit, I would like to ask him what sales volume he obtained in Wisconsin.

The Court: If you will show me the materiality of it I will permit you to get it on the record. Since I think it is not material, I have sustained the objection and you may put it in the form of a proffer.

Mr. Lauritzen: May I say that Mr. Steussy will later testify as to a business connection he has since he left Fidelity, and with regard to efforts that he has made in trying to sell similar contracts for a life insurance company. There has been voluminous testimony introduced by the debtor here as to the possibility and desirability of Fidelity continuing in some form of a life insurance company. This witness is going to be a man who will tell you exactly what his experience in that very field has been.

The Court: Mr. Lauritzen, I have asked you twice about whether this witness is to be used as an expert witness or a witness to facts. You have told me that he is to be used as a witness to facts. I have ruled as to the facts. They are [fol. 3056] immaterial and therefore I sustain the objection. If you are simply qualifying him as an expert witness, and that is the sole bearing of the testimony that you are trying to elicit, and that is the sole purpose of the testimony, then my ruling would be different, because probably it is material in qualifying him as an expert witness.

Mr. Lauritzen: I don't think we understand each other. I will say that I believe Mr. Steussy is an expert witness, and if the Court will permit me, I would like to qualify him as such. If I fail in that, then these objections will be made and sustained on the same ground your Honor has already ruled.

The Court: The question will be permitted for the sole purpose of qualifying him as an expert witness.

Mr. Lauritzen:

Q. Will you now tell us what methods you pursued and what you did and what the results were in recruiting your sales force in Wisconsin on behalf of Fidelity?

A. From the beginning?

Mr. Ray: Just a minute. I object.

The Court: I didn't say I would permit your question [fol. 3057] to be used—

Mr. Lauritzen:

Q. Then tell us what you did and what results you achieved. Tell us what results you achieved.

The Court: The only question that this Court will permit along this line is for a qualifying question, to qualify this witness as an expert. You may ask him how many salesmen he got together, whether he operated, and the length of time he operated with those salesmen, and the degree of success that he had; but as to details of his methods and so on; that has nothing to do with the case.

Mr. Lauritzen: That is what I want to bring out. How many salesmen did you finally have working under you in Wisconsin?

A. The first year I developed an organization of about forty salesmen—forty-two, I think, is the correct figure. The second year that amount grew to some sixty-odd. Then that brought us to 1932. Then we lost a few—but from 1934, that organization kept growing, and in 1938 I had a license with the State Banking Department of Wisconsin and the northern peninsula of Michigan. I had some 225 men. The volume of business had reached, in the last month I operated, over a million dollars per month.

[fol. 3058] Q. Now, Mr. Steussy, did you have occasion, while you were with the company, to have statistics and tables prepared relative to the efficiency of your group of salesmen as measured against the efficiency of other salesmen within the Fidelity Association?

Mr. Ray: We object.

The Court: Overruled.

A. We had tables of all district operations furnished us monthly.

Q. And how did your men compare in production and efficiency with the general run of salesmen?

A. Well, I think that our office without exception ranked in top position in all, measuring what they did by form of record, an average of nine months out of every twelve for each year that I was in the company, from the 7th of April 1931 to the 31st of December last year.

Q. What were some of the tests of efficiency that you used?

A. Volume per man in the organization, volume per producer, collections per unit, persistency of the business, the size per unit sale. I think that covers it.

Q. Will you tell us the nature of your arrangement with [fol. 3059] Fidelity? What kind of a contract did you have?

A. When Mr. Pufer hired me, he had the territory west of Ohio. He was the supervisor. He hired me under a manager contract. In 1934, I believe it was, when Mr. Evans was made director of agencies, he gave me a direct contract in May, giving me the entire territory direct from the home office by direct contract.

Q. Now, you received a commission on the production of your men? Is that correct?

A. That is correct.

Q. That's all you received?

A. The company in its contract with me undertook what we called "stationary expense," such as rent, light, heat, power, and a limited amount of clerical help. All other expense such as long-distance telephone, advertising, additional office help beyond the amount allowed—

Mr. T. C. Townsend: That is going pretty far afield, it seems to me.

The Court: Sustained.

Mr. Lauritzen:

Q. Did you receive any salary?

A. I did not.

Q. And out of what you received as commission you had [fol. 3060] to pay certain expenses?

A. That's correct.

Q. You were running this more or less in a way as your own business? Am I correct in that?

A. Yes.

Mr. Ray: This has no pertinency to these issues. We object.

The Court: I sustain the objection.

Mr. Ray: I should think counsel would stop it.

The Court: I told counsel the only questions permitted here at present are questions qualifying this man as an expert, unless you ask questions that the Court feels are pertinent to the case factually.

Mr. Farmer: If the Court please, I don't like to butt in on this; but the debtor offered quite a number of witnesses whose experience had been along the same line as the man who is now on the witness stand.

Mr. T. C. Townsend: Who were those witnesses?

Mr. Farmer: Mr. Pulfer and Mr. Reed.

The Court: Mr. Pulfer was a member of the board of directors of the company and had a great deal to tell about the factual issues.

[fol. 3061] Mr. Farmer: And Mr. Reed was an honorary vice-president and he went around and——

Mr. Jaegerman: I think Mr. Palmer told Mr. Reed——

The Court: That doesn't have a thing in the world to do with whether this witness' testimony is pertinent or not.

Mr. Farmer: I was telling you why. They got up on the witness stand and expressed opinions about whether this company could be reorganized, and about the salability of these face amount——

The Court: I suppose this man will too if he is qualified.

Mr. Farmer: And they won't let Mr. Lauritzen qualify him. Here is a man whose experience has been such as it is, and he wants to tell about it, and Mr. Lauritzen has brought him here to testify about it.

The Court: It is too bad we can't satisfy you, Mr. Farmer. The Court can't let evidence in except as is indicated, so I will ask counsel to confine his examination to that line.

Mr. Lauritzen:

Q: Did you yourself personally train salesmen?

[fol. 3062] A. Yes, sir.

Q. In that training course, did you make them fully familiar with the Wisconsin law relating to Fidelity's operations?

A. Very definitely.

Mr. Ray: We object.

The Court: Sustained. Strike out the answer.

Mr. Lauritzen: Q. This may not be material as to qualifying this gentleman. Surely it is material in the representations that were made to Wisconsin contract holders of the manner in which the sales campaign was conducted.

The Court: It doesn't make any difference.

Mr. Lauritzen: What I asked him was whether he instructed his men in those particulars.

The Court: No. I sustain the objection.

Mr. Lauritzen:

Q. Did you advise them of the law?

Mr. Ray: We object.

The Court: I sustain the objection.

Mr. Ray: That wouldn't have a thing to do with it.

Mr. Lauritzen: As to whether the salesmen, when they were given their training course and told what they were to [fol. 3063] present to the public, were told that they were to present to the public the situation with respect to the operation of the laws of Wisconsin upon that contract?

The Court: I sustain the objection.

(Whereupon at 3:20 o'clock P. M. a recess was taken until 3:32 o'clock P. M.)

After Recess

Mr. Lauritzen:

Q. I believe you told us that your work with Fidelity was of recruiting, managing, and directing a sales force?

A. I did.

Q. How did you get your salesmen in Fidelity?

Mr. Ray: Your Honor, that is irrelevant. We don't care how he got them. I don't believe it makes a bit of difference.

The Court: Overruled.

A. I got them by personal contact, through bank contacts in the cities and villages throughout the State, and through newspaper advertising, in the want-ad columns in the newspaper.

Mr. Lauritzen:

Q. And did you become familiar with the difficulties and problems generally of recruiting salesmen for this type [fol. 3064] of operation?

A. Yes, sir.

Q. Did you become familiar with what the ratio would be as to the number of men you would have to interview to get one man?

Mr. Ray: If the Court please, that has been gone into several times. There is no issue about it. It is irrelevant.

The Court: Who was the other witness?

Mr. Ray: Carroll Evans.

Mr. Palmer: I understand this question is asked to show this man's qualifications in order to answer the hypotheti-

cal question later on, not the truth as to facts one way or the other.

The Court: That is the only reason why this is being admitted.

Mr. Palmer: The truth of the answer doesn't make any difference. It is a question to show his experience.

The Court: Overruled.

Mr. Lauritzen: Will you read the question.

(The question was read.)

A. By actual statistics—

[fol. 3065] The Court: He just asked you a question to be answered Yes or No.

A. Yes.

Mr. Lauritzen: Mr. Steussy, did you become familiar with the length of time and effort it took to train a particular salesman and to impress upon him the sales policies and practices of Fidelity?

A. Yes.

Mr. Ray: The same objection.

A. Yes.

The Court: Overruled.

Mr. Lauritzen:

Q. How long were you with Fidelity? From what time to what time?

Mr. T. W. Townsend: I believe he answered—

A. April 7th 1931 to the 31st of December 1940.

Mr. Lauritzen:

Q. And when you left Fidelity, where did you go?

A. Franklin Life Insurance Company, Springfield, Illinois.

Q. In what position?

A. Capacity of vice-president in charge of annuity sales.

Q. Will you tell us just what that meant, as to what your [fol. 3066] duties were.

A. My duties were stimulation in the recruiting of life insurance salesmen generally, and particularly in teaching them the annuity selling business.

Q. And are you still with the Franklin Life Insurance Company in that capacity?

A. I am.

Q. What particular type of contract sold by Franklin Life Insurance Company have you been concerned with in your work?

Mr. Huwe: I object.

The Court: Overruled.

A. The contract created last Fall to take the place of a contract that our agents were selling, issued by the Great American Underwriters in Texas, which was a face amount certificate. This contract was constructed as a life insurance policy with six premium years on a monthly payment basis, at the end of a certain waiting period creating a cash value for which a life annuity could be purchased at the time it matured, or get it thereafter with the interest computed at 3% annually after maturity.

Mr. Huwe: I move that the answer be stricken either [fol. 3067] qualifying him as an expert or with reference to this particular hearing.

The Court: Overruled.

Mr. Lauritzen: Mr. Steussy, was that a contract originated by Franklin?

A. Originated by Franklin when the Investment Act of 1940 rendered their Underwriter's certificate unsalable after the first of the year, because it didn't comply with that Act.

Q. Then do I understand that Franklin was selling what you term the "Underwriter's certificate" prior to January 1st 1941?

A. Franklin's agents were selling that certificate; that is right.

Q. And, Mr. Steussy, in how many states were they selling that certificate?

A. They were selling that certificate in Texas—the answer is five states.

Q. Now, with regard to the presnet contract with which you went with Franklin Life to promote the sale of, in how many states was that policy filed with the state authorities and offered for sale?

[fol. 3068] A. Qualified in eighteen states.

Q. Including the State of Wisconsin?

A. Correct.

Q. Mr. Steussy, when you went with Franklin in the capacity that you just related, I take it that you again engaged in the business of recruiting salesmen?

A. Correct.

Q. And in recruiting salesmen, did you take on any of those that had been with Fidelity?

Mr. Ray: That certainly is irrelevant.

The Court: What is the purpose of that, Mr. Lauritzen? Do you want to show that they have got them now and can't get them back?

Mr. Lauritzen: If the Court please, we want to show, your Honor, the experience of the same men who had sold for Fidelity under Mr. Steussy and their experience in selling under Mr. Steussy under this present contract that the Franklin Life Insurance Company is offering.

The Court: It is too remote. I sustain the objection.

Mr. Palmer: Some of the witnesses were testifying in great detail that the Franklin Life Insurance Company was selling contracts very similar to what any reorganized company would sell and having no difficulty. I believe this would be pertinent and contradictory, if the Court will allow the statement of that witness—

The Court: That isn't the point. He is asking what Fidelity salesmen got.

Mr. Palmer; I presumed he was leading up to a comparison of their selling experience afterward and before, and this was really a qualifying question.

The Court: Let's go direct to what the experience is in selling this contract, and not complicate that with questions about former salesmen of Fidelity.

Mr. Lauritzen: All right, your Honor. Mr. Steussy, have your efforts in attempting to sell the new Franklin Life contract been comparable to those which you put forth in selling the Fidelity contracts?

Mr. Ray: We want to object, because there are so many differences between the new contract and the Fidelity contract.

The Court: Overruled.

A. We find the selling of the savings contract very difficult.

Mr. Lauritzen:

Q. What I mean by that, did you use the same type of [fol. 3070] sales effort and put the same amount of energy and time into it?

A. Very definitely, and employing the same men.

Q. Mr. Steussy, what success have you had in selling this Franklin contract?

A. Very disappointing.

Q. Will you elaborate on that a little bit?

A. When we first started out—

Mr. Ray: We object to that.

The Court: Overruled.

A. When we first started out, these men were naturally very happy to have a new connection, realizing that they had some income.

The Court: That doesn't make any difference. Just answer his question.

A. May I say that our sales volume in April, the fourth month, reached \$300,000. By June, with the defense bond program competing very severely, it dropped to a hundred thousand. It has been below that since.

Mr. Lauritzen:

Q. Mr. Steussy, what is the size of the Franklin Insurance Company and how long has it been in business?

[fol. 3071] A. Fifty-seven years, and their resources are slightly in excess of forty-five million dollars.

Q. Mr. Steussy, can you give us the reason why your efforts to sell this Franklin contract have not been successful?

Mr. Ray: We object, your Honor.

The Court: Sustained.

Mr. Lauritzen:

Q. Mr. Steussy, can you tell us, did you have occasion to find out in your experience, as you have related it, what it costs to build a sales force comparable to that which you built for Fidelity in Wisconsin?

Mr. Ray: We object to that, your Honor.
The Court: Overruled.

A. I did.

Mr. Lauritzen:

Q. Mr. Steussy, if you were again to attempt to recruit such a sales force, would those costs be greater or less than they were when you recruited them?

A. Four hundred per cent greater.

Mr. Huwe: Your Honor, I move the answer as well as the question be stricken. Here is a man who has recruited for from five to eighteen states, and to compare the figures of Wisconsin, one state, with five to eighteen where the law [fol. 3072] might be different, where there might not be any deposit, and therefore any attraction or argument on the salesmen's part, is not comparable. It is not a fair question.

The Court: The Court will make the proper comparison in view of those circumstances, so I will overrule the objection.

Mr. Lauritzen:

Q. Mr. Steussy, you had experience in determining how long salesmen would stay with an organization, such as those that you have been in charge of, have you not?

A. I did.

Mr. Ray: If that is relevant or material, it certainly has been gone into in this hearing. Mr. Evans and other witnesses on cross-examination have been asked about that over and over again. There doesn't seem to be much dispute about what the turnover is.

The Court: It is a qualifying question. I overrule the objection.

Mr. Lauritzen: Mr. Steussy, in your opinion, would you have a greater or less turnover in salesmen if you were now starting to recruit a sales force for Fidelity or some similar organization?

[fol. 3073] A. My experience is that it is greater.

Mr. Ray: Objection.

The Court: Overruled.

Mr. Lauritzen: I didn't hear that.

A. My experience is that it is greater.

Q. Can you tell us why that is true, Mr. Steussy?

Mr. Ray: Mr. Evans went into all these questions, your Honor.

Mr. Lauritzen: Mr. Ray, Mr. Evans wasn't my witness.

Mr. Ray: I don't care whose witness he was. He was put on the stand and testified to these facts, and they have not been disputed.

Mr. Lauritzen: I don't know what this witness' answer may be.

The Court: He is attempting to answer now a question which is based on the qualification that he has been shown, I am sure, to possess: The question, as I understand it, asks him to give his opinion. I will overrule the objection.

A. Chiefly because they cannot get into production as quick as they used to, because the market isn't there for a saving certificate.

[fol. 3074] Mr. Lauritzen:

Q. And why is that?

A. Due to the fact that the costs of living are high, out of proportion with earnings, and the defense bond is keenly felt—sale of the defense bond.

Q. Can you tell us whether or not the sale of installment Building and Loan Association stock on the installment plan has any thing to do with that situation?

A. They dropped there because of the insurance, very definitely and yet their sales show a drop in the last six months due to the fact that the market has changed.

Q. You mean because they are insured by Federal insurance?

A. By an agency of the Federal Government. That is right.

The Court: Mr. Steussy, do you find the same situation applied to the sale of life insurance contracts?

A. The so-called savings side of the life insurance contracts. In other words, the sales of annuity endowments, high premium life insurance is now at a new low, and the low premium life insurance is constantly offsetting that volume loss the other way. In other words, the men who must pay, as they anticipate, increased taxes this year,

[fol. 3075] must immediately establish for their families additional resources in the event of death to offset losses of that kind, which they must pay out; hence, it has stimulated the sale of the so-called low premium insurance, and it has curtailed the sale of so-called high premium insurance. That is universally and nationally our picture, here and in Canada both.

Mr. Lauritzen:

Q. Do you know of any life insurance company that is presently making a success of selling its savings type of annuity policies or contracts?

A. They are all finding the same report that I have just given on our situation—those with whom I am familiar—and I believe I know the entire setup.

Q. By reason of this situation existing, what action has your firm taken with respect to the cessation of efforts to sell this particular contract, or either to drop it or to make increased efforts to put it across?

Mr. Ray: We object your Honor.

The Court: Sustained.

Mr. Lauritzen: Mr. Steussy, in your work, have you become familiar with the fact that oftentimes one life insurance company takes over or reinsures various types of [fol. 3076] policies or contracts issued by other life insurance companies?

A. I have.

Q. And in your experience, under what circumstances will it be desirable for a life insurance company to take over or reinsure such other policies or contracts?

Mr. Ray: Your Honor, the vast subject of reinsurance has no place in this hearing.

The Court: I sustain the objection.

Mr. Ray: We can talk a week just on that.

Mr. Lauritzen: If the Court please, there has been an overwhelming, a voluminous amount of testimony here as to the fact that various officers and people in Fidelity felt and still feel that a life insurance company might be able to take Fidelity over. Now, I think Mr. Steussy has amply qualified himself to state what the facts are which would lead to a life insurance company doing such a thing.

The Court: That doesn't have anything to do with re-insurance.

Mr. Lauritzen: Let me strike the term "reinsurance." What I mean is taking over and continuing the business of [fol. 3077] another company selling such a contract as Fidelity's, or some other form of saving plan.

Mr. Ray: You didn't ask him if he had any experience along that line—

Mr. Lauritzen: I now amend that, Mr. Ray.

Q. Would you like the question read?

A. As it is amended.

(The question was read as amended.)

The Court: He asked this witness if he had had any such experience as that.

Mr. Lauritzen: Whether he had any experience which would enable him to tell us under what circumstances a life insurance company would find it desirable to take over a company issuing such contracts. Have you had any such experience, Mr. Steussy?

The Court: I think I would have to sustain the objection to the question in that form. You are leaving it to the witness, whether he has experience that will enable him to tell that or not. If what you are doing is to find out what experience he has had, then we will see whether that qualifies him.

Mr. Lauritzen:

Q. Mr. Steussy, in your connection with the Franklin [fol. 3078] Life Insurance Company, have you had experience with that company considering various propositions made to them to take over companies selling face amount certificates or some comparable contract?

The Court: That won't do.

Mr. Lauritzen:

Q. What experience have you had with respect to your company's having analyzed the prospects and determining for itself the desirability of taking over a company selling face amount certificates?

The Court: I will admit that question if the witness has had experience in the actual taking over and operation;

you may bring that out and then that will qualify him by what his company is considering to do; otherwise I don't think it will qualify him.

Mr. Lauritzen: He is permitted to testify as to what facts and circumstances must exist for a company to undertake taking over such a company, if he can answer my next question.

The Court: I have ruled on that.

Mr. Lauritzen:

Q. Has the Franklin Life Insurance Company taken over any companies selling annuity policies?

Mr. Ray: We object to that because annuity policies are insurance policies, and it may have reinsured insurance [fol. 3079] policies. That isn't taking over a face amount certificate company.

The Court: What kind of annuities do you mean?

Mr. Lauritzen: Annuity contracts based on a savings feature of placing installment payments with a concern for the purpose of accumulating a sum of money; in other words, on the savings side of a life insurance annuity policy.

The Court: Without life insurance as a part of them?

Mr. Lauritzen: Or with life insurance as a part of them.

Mr. Ray: You cannot have an annuity without insurance, as I understand it.

The Court: If you divorce it from insurance I will permit the answer.

Mr. Lauritzen: When Fidelity sold its series B, which was, in effect, an annuity coupled with insurance—

The Court: It wasn't life insurance. It was insurance that would pay out the face amount of the certificate.

Mr. Lauritzen: But it was life insurance on the life of the contract holder?

The Court: Life insurance to that extent.

Mr. Lauritzen: Well, now, let me clarify that, will you, [fol. 3080] Mr. Steussy.

Q. Will you explain for us, if you can, the similarity or differences in the contract which Franklin Life Insurance Company has been attempting to sell, with the contract which Fidelity sold having the insurance feature.

—A. The contract Franklin is now selling is an improved face amount certificate taken over from the Great American Underwriters and since that qualifies as an insurance policy, the face amount certificate was reconstructed just as the Fidelity contract would have to be reconstructed if the Fidelity Assurance Association was going to operate as an insurance corporation—briefly, that is it.

Q. Was that Great American Underwriters contract a contract similar to Fidelity's?

A. So much alike that they were almost like twins.

Q. Now, can you tell us, was that the same contract that has proved successful with your firm? Is that not correct?

A. That contract was sold up to the close of last year.

Q. And now that contract business has been taken over by Franklin?

[fol. 3081] A. And the same sales people are selling it in the new form.

Q. Yes. And in that new form, you haven't been able to sell it, as I understand you?

A. Last December they sold a million dollars' worth of face amount certificates, a little over a million and forty-odd thousand of the Great American certificate, and their January sales were two hundred thousand; at the end of April we reached three hundred thousand face amount, and since then it has been going down.

Q. And is it your opinion that it will continue to go down?

A. It will always sell, because it is in the rate book. Life insurance companies put everything in their rate book. It is part of their line, part of the "57 varieties." Salesmen here and there will find a good need for that type of form.

Q. But you believe that the demand and sale of such a policy is decreasing at the present?

A. Materially.

The Court: Mr. Steussy, does the salability of a contract of this kind depend largely on the vigor with which [fol. 3082] the salesman pushes it, as against other forms of contracts or policies?

A. I would like to answer that by saying this to you, that the unfortunate thing of a life insurance man talking to the prospective buyer about a savings account is this: Let us say he is going to save \$150 a year, twelve and a

half dollars a month, and he only gets a thousand dollars of life coverage in this so-called certificate. For that same \$150 he can get a low premium life insurance policy and get his family ten or twelve thousand dollars of protection. That is the stumbling block of tying up a so-called monthly savings program with a life insurance policy, and that has definitely been the experience of the Great American certificate and the Franklin plan in trying to sell it as—

The Court: What I am trying to find out is, if there is a definite connection between the salability of one of these savings plans and the vigor with which the salesmen push it, as distinguished between it and some other plan.

A. Of course, it's needless to say that a man, if he is excited about something, enthusiastic, can do a better job of selling, but believe me when I say to you, we tried [fol. 3083] exactly the same methods and just couldn't get that enthusiasm up to where it did the trick.

Mr. Lauritzen: I think I might clarify that.

Q. Did you not, in effect, in your connection with Franklin, set up what we might term, in the Franklin Life Insurance Company, a separate division with respect to the activity and force used in sales and placing that force and activity entirely behind this annuity type contract which you testified they had created?

Mr. Ray: Your Honor, I don't see how that could be material.

The Court: Overruled.

A. We very definitely had special training classes and gave special training to a special group of men who, to all intents and purposes, specialized in that matter.

Mr. Lauritzen:

Q. Were a great number of those men the men who had been at the top in selling for Fidelity under your supervision?

A. That's correct.

Q. Now, after the S. E. C. investigation in 1938, it became very difficult to sell the Fidelity contract, is that right?

A. That's also correct.

[fol. 3084] Q. Were there some of your men in Fidelity who were nevertheless able to sell Fidelity contracts at all times after this S. E. C. investigation?

A. I was able to retain out of 225 that I had under license in 1938 thirty-seven for 1939.

Q. And did a number of those men sell Fidelity under those circumstances—

Mr. Ray: I object.

The Court: Sustained. I thought the Court made it plain, since there is no controversy as to the particular fact that you are asking about now, that there is no use putting and duplicating the questions on the record. This witness was qualified to give his opinion as an expert. The Court will permit him to give his opinion as an expert, but not give cumulative testimony of what has already been gone into.

Mr. Lauritzen: I think my next question will clarify it. Of the salesmen that you took into the Franklin setup from Fidelity, were those the salesmen who had, after the S. E. C. investigation, been able to continue and still make a living selling the Fidelity contract?

Mr. Ray: Objection.

[fol. 3085] The Court: Overruled.

A. Only those salesmen that were able to carry on and keep themselves above water, so to speak, were the ones that I took in.

Mr. Lauritzen:

Q. What has been the experience of those men?

A. I took twelve men with me from Wisconsin, and I have one of them left.

Q. And what happened to the eleven?

A. They have passed out of the picture.

Q. And why?

A. They were unable to sell a sufficient volume to stay in the business.

Q. In addition to those twelve men, did Franklin take on some other Fidelity men in various places in the country in which Fidelity or Franklin was selling?

A. About a half dozen in Michigan, eight in Ohio, about six in Illinois, a dozen in Missouri and Kansas combined, and we sent some from those states into other states.

Q. And what has their experience been?

A. There are now a total of five of them left.

Q. Was the American—can you give me the name again?
[fol. 3086] A. Great American Underwriters.

Q. Was the Great American Underwriters the only type of face amount certificate company that Franklin ever took over?

A. That's correct.

Q. Have they considered taking over others?

Mr. Ray: Your Honor, I object.

The Court: Sustained. Mr. Steussy, do you know what these salesmen of Fidelity other than the five you still have working for you are doing?

A. Yes; I know what a great many of them are doing.

Q. Are they working along the same line as they formerly did, as salesmen?

A. No. That would be about fifty-fifty.

Q. You mean fifty per cent are still engaged in some form of salesmanship similar to that which they did before?

A. They are selling tangibles.

Q. The other fifty per cent—are they employed at anything, as far as you know?

A. I know of one man who has gone into Y. M. C. A. work. Another man has gone into a manufacturing plant. I know of another man who has gone into another manu-
[fol. 3087] facturing plant; another who has gone into the mortgage and real estate business; another who has gone into the stock selling business.

Q. By selling "tangibles" do you mean something other than an investment, whether a life insurance or new contracts or stocks and bonds, anything of that sort?

A. I mean goods of various industries—sash and doors, building supplies, iceboxes, automobiles, and so on.

Q. When a company has a large number of contract holders such as Fidelity did, and sold a large number of contracts, may it under some circumstances be desirable for another organization to take that organization over and continue it in business?

A. Very definitely.

Q. Now, with respect to your knowledge of Fidelity's affairs, do you believe it would be advantageous for any organization to take over Fidelity in that manner?

A. Very definitely not.

Q. Will you amplify that?

A. It has lost that which a company taking it over is after—the sales organization. It has disappeared, disassembled and disintegrated.

[fol. 3088] The Court: I thought you meant, when you said it would not be advantageous to take it over, that it would not be advantageous to the holders of contracts in that company.

A. Oh, no.

The Court: I judge from your answer you mean it would not be advantageous to the outside company.

A. The company taking it over—that's right.

Mr. Lauritzen: With respect to contract holders of Fidelity, do you believe it would or would not be advantageous to them to have Fidelity taken over by another organization and continued in business?

Mr. Ray: We object to that, your Honor.

The Court: Overruled.

A. I would say that it would be a disadvantage to them.

Mr. Lauritzen:

Q. Will you amplify that?

Mr. Ray: I don't like that word "amplify." I want to know why he makes that statement.

Mr. Lauritzen:

Q. Will you give the basis for your statement?

A. The basis for my statement is this: Anybody that takes it over must make some money in order to continue to take it over, and that would be transferring equities [fol. 3089] into a new kind of paper which would mean a new load, because of the fact that the very same purchaser would have to pay in more money—when he found it would be better to take a loss, keep what he already has, instead of paying in, take another loss and make it a disappointment later on.

The Court: You seem to base your answer on a very fanciful fabric of your own mind which was not in the question. Do you have any ideas independent of this imaginary fabric that you have built up?

A. Will you ask me a direct question?

The Court: I ask you—will you read the question.

(The question of the Court was read.)

A. Your Honor, of course I have talked to a great many thousands of Wisconsin contract holders since 1938. I was born and raised in the State. I know a great many of them personally. I know their ways. I know their methods—their way of living, and I believe that I can say to you very definitely that what I said wasn't something that I haven't thought about a great deal. I believe that my statement wasn't at all fanciful. I think it is the truth and very evident, so far as my Wisconsin people are concerned. [fol. 3090]. The Court: Now, you said it would be a disadvantage if some structure were formed and transfer made to a new company, that it would take money from the equities of contract holders and create some new form of obligation. It would give them less than what they now have. Of course that is quite apparent without your answering. If the question and answer are going to be of any benefit to the Court, you have got to base it on something different from that. You have to base it on the assumption that there will not be taken anything from the equity of the contract holders or given to anybody at all. If you have any answer based on that assumption, the Court will be glad to hear it.

A. I can say this too, that the sales people that I tried to adopt—or adapt to the new operation—that we had to adapt ourselves to—where does a salesman logically go but back to his old customers to get new names, and I often find that the people who are now so-called delinquent have found a new outlet for that money, have made new commitments, and in most cases would be unable to again reinstate themselves and continue payments as they are now making. They could, of course, get the benefit of what a paid-up contract would do for them if a firm rate of interest [fol. 3091] would prevail.

Mr. Lauritzen:

Q. Mr. Steussy, in your answer, you mentioned a company taking them over and paying a new loading charge. Is that based on some experience that you have had with respect to contract holders surrendering policies in—

The Court: I sustained the objection and will ask counsel to base no questions on any assumption that there will be any equity taken from anybody that has equities.

Mr. Lauritzen: I don't mean to base my question on any such assumption, but what I am getting at is this: Let us say, Mr. Steussy, that Mr. Jones, a contract holder in Wisconsin or elsewhere, has a par cash surrender value of a thousand dollars, and that if the rights which were attempted to be secured to him under the Wisconsin laws were left unimpaired and he got that thousand dollars, what is your answer with respect to the desirability of that man going into an organization either taking over or created out of Fidelity.

The Court: Well, the Court knows about as much about that as this witness could. I sustain the objection.

Mr. Lauritzen: Mr. Steussy, in selling Fidelity's con-[fol. 3092] tracts in Wisconsin, was it a factor of assistance in the sales organization that there is in existence in Wisconsin certain laws relating to Fidelity?

Mr. Ray: We object to that, your Honor.

The Court: Sustained.

Mr. Lauritzen: If the Court please, I think this would bear directly on Mr. Steussy's testimony that if you have no such factor, as to whether or not it would be more difficult to sell another type of contract or whether that difficulty might be overcome in some manner.

The Court: The question clearly calls for an opinion of the witness, and the Court is just as well advised before as after as to whether that law would have been a factor.

Mr. Lauritzen: If the Court please, I asked him in his actual experience as head of this sales organization, what effect, beneficial or otherwise, on the ease of selling that factor has—not his opinion but what his experience was as head of this sales force.

The Court: Now you are changing your question. Read the question, please.

(The question was read.)

[fol. 3093] The Court: I sustain the objection.

Mr. Lauritzen:

Q. Let me ask you this, Mr. Steussy. Was that law of aid to Fidelity's force in Wisconsin?

Mr. Ray: Your Honor, that is the same question.

Mr. Lauritzen: I don't think so. The Court just explained the distinction. Now, let us say—

The Court: You say, "Was that law of aid?"

Mr. Ray: And the other was, "Was it a factor of assistance?"

The Court: I don't see any distinction.

Mr. Lauritzen: In the Court's previous ruling the Court ruled—

The Court: I sustain the objection.

Mr. Ray: We objected because it isn't material.

Mr. Lauritzen: I believe that is about as material a thing as we could possibly have, both as regard to Wisconsin contract holders, whether they are going to get under way with a type of operation similar to this in the future—

The Court: I sustained the objection. If you have a law out there in which the present holders are protected 110%, then that law will be just as effective, whether it was of assistance in selling a contract or not; so I don't see [fol. 3094] that it is at all material.

Mr. Lauritzen: Just this, if the Court please: If they were attempting to sell some sort of insurance contract which would become subject to the Wisconsin insurance laws, this law would no longer be a factor at all. They would be operating, under those circumstances, under an entirely different part of the law, and any assistance that might have been given them in the past, in being able to quote this law, would not be in existence under the new situation.

Mr. Ray: Certainly if this contract which the Franklin is selling is so different, then the same Wisconsin law cannot apply. I got the idea from the witness' discussion that it was quite different. Now the attorney from Wisconsin tells the Court that it is so different that it is not even restricted by the same statutes in Wisconsin.

Mr. Lauritzen: Only for the purpose of illustrating and forming a basis for Mr. Steussy's previous opinion as to the difficulty that you now have in getting under way with any savings plan, if you couldn't have the benefit of such a law.

The Court: Let's go ahead. The court has ruled.

[fol. 3095] Mr. Lauritzen:

Q. To your knowledge, Mr. Steussy, did the Banking Commission of Wisconsin at one time become concerned for the safety of Wisconsin contract holders of Fidelity?

Mr. Ray: We object.
The Court: Sustained.

Mr. Lauritzen:

Q. Mr. Steussy, did Fidelity have negotiations in which you took a part with the Banking Commission of Wisconsin relative to ascertaining the safety that was being provided for Fidelity holders in Wisconsin, and what their rights were?

Mr. Ray: We object to that, your Honor. That is not relevant to the issues here.

The Court: Sustained.

Mr. Lauritzen: If the Court please, just this: There has been a great deal of testimony and discussion in this case to the effect that these deposit laws—whether it was on a total contract liability basis in the various states; and in that connection, I desire to bring out through Mr. Steussy the direct representations that were made by Fidelity through its counsel and officers to the State authorities of Wisconsin, as to defining the rights of those contract holders, which rights will ultimately have to be decided [fol. 3096] in this proceeding, both as to whether there can be a reorganization, and if there is a reorganization, as to what their rights will be. I think that is a subject that we have gone into at considerable length here during this hearing.

Mr. Ray: That subject isn't pertinent to the matters which the Court must decide, and what has been gone into has been brought into the case by cross-examination of Mr. Lauritzen over our objections, and why should he now bring a witness in to testify to matters which are now immaterial which he has himself brought into the record?

The Court: You don't think that is material now?

Mr. Lauritzen: Definitely, your Honor.

The Court: I mean on the question of good faith.

Mr. Lauritzen: On the question of feasibility of the thing—just this: If the Wisconsin law is valid, both as written and as administered; and if the terms of the contract which, by reason of that law, and the contract of Fidelity and representations made to contract holders—that that trust deposit out there is entirely valid under the representations that Fidelity made, then it will have a great effect in determining whether there can be a re-

[fol. 3097] organization, because that would remove the possibility of the reducing, over the objection of any of those contract holders, of those equities and would make more difficult the search for additional capital, which apparently and without question must be found somewhere, if Fidelity were to continue both to comply with the present state laws which are not abrogated and with the Investment Company Act of 1940, which is on a plain arithmetical basis. I think that is of the essence in this proceeding in determining the feasibility of any plan which might be proposed or determined, whether any possible plan could be proposed.

The Court: It is your contention that the status of the deposit in Wisconsin is to be determined by negotiations between Fidelity and the officers of Wisconsin rather than by the law of Wisconsin?

Mr. Lauritzen: I would say, your Honor, that if there were any room for doubt in the construction of the law, that the practical application of it, as between the authorities in charge of administering that law and the officers of Fidelity in setting up a deposit for the benefit of the contract holders would be very material.

The Court: I sustain the objection.

[fol. 3098] Mr. Lauritzen: Mr. Steussy, do you recognize this document which I show you?

A. Yes, sir. (Examining document.)

Q. Will you tell us what it is.

A. It is a part of the sales kit that we used in the sale of the contract, in the sale in Wisconsin.

Mr. Ray: I can't see that anything in the sales kit in selling contracts in Wisconsin is relevant to the issues before the Court.

Mr. Lauritzen: It has already been ruled, and there is evidence in the record here, as to representations made in other states, and surely these representations must be of equal value as those.

The Court: I will overrule the objection.

Exhibit 106

The paper referred to was marked for identification, at the request of Mr. Lauritzen, as above indicated.

Mr. Lauritzen: We offer in evidence Exhibit 106.

Exhibit 106

The paper referred to, having been previously marked as above indicated, was admitted in evidence. The same is attached hereto as a part hereof.

[fol. 3099] Mr. Lauritzen:

Q. Mr. Steussy, are you a stockholder in Fidelity Assurance Association?

A. Yes, sir.

Q. And how much stock do you hold?

A. Ten shares of common and five shares of preferred.

Q. Can you tell us what you paid for it?

Mr. Ray: We object, your Honor.

The Court: Sustained.

Mr. Lauritzen: I think, if your Honor please, this would show the interest of Mr. Steussy and would provide a criterion for the Court in determining the value of his testimony.

The Court: What difference does it make if we know what he paid for it if we know it isn't worth anything?

Mr. Lauritzen:

Q. May I ask, did you pay money for it?

A. I did.

Q. How long ago did you get it?

A. 1932, I purchased the common and the preferred I got as a dividend.

Q. I didn't hear that.

A. Purchased the common in 1932 and the preferred I got as a dividend later on, and I kept it.

[fol. 3100] Q. Mr. Steussy, Fidelity sold various contracts of various types—am I correct in that?

A. That is right.

Q. When Fidelity came out with a new series of contracts, what instructions did you receive from the home office of Fidelity as to contacting previous contract holders with respect to the purchase of a new contract?

Mr. Ray: Your Honor, I object to the question. I can't see how that would be relevant to the issue of jurisdiction—

Mr. Lauritzen: Just this, your Honor: If it is shown that by numerous switches of contract holders from one

contract into another, it provided a basis for giving a salesman something to sell, and provided a man a livelihood and kept him on with the company, and further, was a source of profit to the company, the availability of such inducements to salesmen and such inducements to the company in the future would have a great bearing on prospective earnings of income.

The Court: It is too remote. I sustain the objection.

Mr. Lauritzen:

Q. Mr. Steussy, from your experience, can you tell us how much you estimated it would cost in dollars to develop [fol. 3101] a sales force for a company comparable to Fidelity, a sales force comparable to that which you had in Wisconsin?

Mr. Ray: We object. In the first place, when he uses the words "How much it would cost," the costs of developing a sales force do not all fall—in the past did not all fall upon the company.

Mr. Lauritzen: I realize that fully, Mr. Ray.

Mr. Ray: If you had some way of getting at the net cost to the company, it might mean something.

Mr. Lauritzen: That is what I mean to ask him.

The Court: It seems to me when you are attempting to confine it to the State of Wisconsin that you are very much too localized to be of any assistance to the Court. I sustain the objection to that question.

Mr. Lauritzen: I think that's all for the present, Mr. Steussy.

Mr. Palmer: May I have permission to examine the witness on one phase?

Mr. Ray: What is that?

Mr. Palmer: I understood the witness to say he did not think Fidelity could be reorganized in any way and should [fol. 3102] be liquidated.

Mr. Ray: I didn't understand him to say that.

The Court: Yes, I think he did testify to that effect. Go ahead.

Mr. Palmer:

Q. Mr. Steussy, if the Court will permit me, after you became a salesman in Wisconsin or any place else, did you study selling methods?

Mr. Lauritzen: Excuse me, Mr. Palmer. I think you should say, manager of the sales force, because I understand Mr. Steussy was not a direct salesman.

Mr. Palmer:

Q. After you became a sales manager, did you study selling methods?

A. Very definitely.

Mr. Ray: I object to that.

The Court: I don't think we ought to go into the qualifying questions again. Let's get to the heart of anything new.

Mr. Palmer: I wanted to broaden, if possible, his qualifications for the basis of later questions.

The Court: Well, he has already qualified along that line.

Mr. Palmer: I wanted to get what studies he had made; [fol. 3103] in other words, the basis of his—

Mr. Jaegerman: Is Mr. Palmer challenging his qualifications?

Mr. Palmer: No, your Honor. They were given very generally, and I wanted to broaden the qualifications if I can broaden them. In other words, as I understand it, the weight of any expert witness' testimony, the weight which the jury or the Court gives to the witness' testimony depends to a large extent upon the qualifications which he exhibits to that body.

The Court: All right. Without any further argument, go ahead.

Mr. Palmer:

Q. Now, in studying selling methods, did you read books on the subject?

A. A good many volumes. I wrote some—taught salesmanship; been a salesman all my life.

Q. Where were you teaching salesmanship?

A. In a certain small school in Milwaukee—as something to do.

Q. Have you since that time studied insurance?

A. Studied insurance way back in the twenties; studied it all the time as I went along.

[fol. 3104] Q. Did you study face amount securities so you would know the difference between one type and another?

A. I believe I have every type of certificate that has

ever been construed or thought of or sold on record in a file and available.

Q. Have you made a study of them?

A. Very definitely.

Q. Have you made a study of various types of insurance policies?

A. I have bought a good many thousands of dollars' worth of them during my time, and when reverses come, you get delinquent and buy some more. I have certainly studied every branch of life insurance from the corporate sinking fund type to the benefit of the trust fund, which is created by means of insurance purchases, of course.

Q. Now, have you since your employment with the Franklin Insurance Company discussed with other officials of that company the various types of policies which they sell?

A. Very definitely.

Mr. Ray: He is getting into the Franklin Life Insurance Company, which has no relevancy here.

Mr. Palmer: I am getting to it.

Mr. Ray: That is about a fact having to do with another [fol. 3105] company—

The Court: I overrule the objection. See what it leads to.

A. We have regular conferences and intercompany study and meetings on the different types of instruments that we sell, very obviously, and have district sales meetings. Those are all discussed minutely.

Mr. Palmer:

Q. Do you have outside experts in the insurance field come and lecture and discuss insurance problems with you?

Mr. Huwe: I object. He is doing what Mr. Lauritzen was unable to do, trying to show that they have conferences and consider small insurance companies for reinsurance and all that sort of thing.

The Court: I don't so understand the purpose of his question. He is just trying to find out how much experience this man has in the field in which he operates.

Mr. Huwe: I suggest we get right down to the opinion question, and then if he isn't qualified, I think that is the best way to do it.

The Court: Overruled.

Mr. Palmer: Will you read the question.

(The question was read.)

[fol. 3106] A. We subscribe to, I suppose, all the important services, of which there are many, as you know. We are obviously members of the Life Insurance Company Convention, which Mr. Johnson is president of. We have naturally the benefit of everything available.

Q. Do you read those various journals published on the problems of insurance?

A. That is the reason why I own these glasses. I ruined my eyes doing it.

Mr. Huwe: I object to that answer and move it be stricken.

The Court: Overruled.

Mr. Palmer:

Q. Have you studied the reports made by the S.E.C. to the T.N.E.C. in pursuance to the Act of Congress? Have you read them?

A. I have read them but never studied them.

Q. Have you attempted to familiarize yourself with state laws in various states in which companies operate?

A. Will you state that question again?

Mr. Palmer: Will you read the question.

(The question was read.)

A. To a limited extent.

[fol. 3107] Q. Now, have you familiarized yourself to any extent or been advised as to the financial condition at present of Fidelity?

A. I believe that I have the information right up to date.

Mr. T. C. Townsend: I didn't get that.

Witness: I have the information right up to date.

Mr. Palmer:

Q. Do you know whether that information is that the general fund is approximately two and one-half million dollars or slightly more in the hole?

A. I believe that is about the figure.

Q. And does your information include the fact, if such it be, that Fidelity, with all of its assets against all of its liabilities, is about ten per cent under water, as it is called?

A. You mean by putting it all into one fund?

Q. Yes.

A. I didn't look at it from the per cent standpoint particularly.

Q. Will you take that as an assumption upon which I may base future questions. Were you also advised that the later series of contracts, A, B, and D, were nearly [fol. 3108] solvent, whereas the early series special annuity and special endowment had their reserve impaired to a far greater extent?

A. That's right.

Q. With those facts in mind, are you prepared to give the Court answers as to your opinion, based upon your experience and background, as to the possibilities or impossibilities of Fidelity being reorganized, or whether it should be entirely liquidated?

Mr. Townsend: I object.

The Court: Overruled.

Mr. Palmer: Will you read the question, please.

(The question was read.)

A. I wish you would read the question again.

(The question was reread.)

A. I will be very glad to answer those questions.

Q. Do you feel prepared and capable of giving answers to them?

A. I do.

Q. Now, keeping in mind the facts of Fidelity which you and I have discussed, so that your opinion with reference to Fidelity is based upon those facts, what have you to say as to whether or not Fidelity can be reorganized into a face amount securities company?

[fol. 3109] Mr. Hume: I object.

Mr. Palmer: All right. I mean a company selling face amount certificates.

Mr. Hume: This man is not qualified to answer that question, because he doesn't have any idea of finances, the-

actuarial features of a business, and is merely qualifying as an expert salesman. He was working, up to 1940, as manager of sales in Wisconsin, and in this short period of nine months, even though he says he read thoroughly the T. N. E. C. reports on insurance companies, and listens to lectures; I say, he is not qualified to answer that question just on the experience that he has related.

The Court: Overruled.

A. The company cannot be reorganized with the loading cost permitted by the 7 per cent of the sum of money paid in by the depositor, or possibly load the contracts so that it can assemble a sales force and be successful in the selling of it.

Mr. Palmer:

Q. Are you basing that upon your experience first with Fidelity and your later experience with Franklin?

A. I am basing it on my experience in following the savings deposit certificates qualified with the S. E. C.

[fols. 3110-3119] Q. My next question is this. It is your further opinion, I gather from what you have told us, that Fidelity cannot be reorganized into a company which would sell a policy or certificate or contract similar to the one that Franklin Life Insurance is selling?

A. A salesman cannot sell one contract with a life insurance company, nor can a life insurance company sell one contract and be in the life insurance business.

Q. So that your answer to my question would be that a company could not be formed from Fidelity which would sell a policy or contract exactly similar to the Franklin policy?

A. The company could not be qualified with an insurance department in most states of this Union.

Q. I want your own opinion as a practical matter whether that company could work and exist.

A. Absolutely not.

[fols. 3120-3140] Mr. T. C. Townsend: Your Honor, the trustee has completed the first installment of its report, and has six copies: one for its office file, one for the Court, two for the S. E. C., and two additional ones. This can

be filed with the Court now or it can be filed with the Court tomorrow morning.

The Court: I suggest you just wait until tomorrow morning.

[fols. 3141-3150] Cross-examination

By Mr. Huwe:

Q. As I take it, Mr. Steussy, you are holding yourself out as an expert with reference to both face amount certificate companies and with reference to insurance companies, as to the buyer's point of view, as to the seller's point of view, as to the financier's point of view, and as to the management's point of view, with the exception of the actuarial feature of the management?

A. That is exactly what I desire you to understand.

Q. That is the impression you desire to make?

A. That's correct.

[fol. 3151] Q. Then you emphasize the factor of rebuilding a sales force. That is the chief reason, you say, that a company like Fidelity could not re-enter successfully under the 1940 Investment Company Act?

A. I didn't say that was the chief reason. It is one of the paramount reasons.

The Court: What is another?

A. Another is that you have to qualify in the different states, which is expensive.

The Court: Doesn't any other company have to do that?

A. Most of them that are in existence are qualified. There are many states that I know of, for instance, if new companies of life insurance wanted to get in, they say, "We have plenty of them now."

The Court: We are talking about companies that qualify under the 1940 Investment Security Act.

A. From my study and observation, I would say to you that it is very remote.

The Court: I don't understand what you are talking about. I want to know what other element there is other than the difficulty of creating a sales force that would pre-

[fol. 3152] vent Fidelity from going ahead as an investment certificate company?

A. Consumer acceptance.

The Court: What is that?

A. Consumer acceptance, purchaser acceptance of the idea of such a plan.

Mr. Palmer: Is the Court assuming that Fidelity could qualify under the Investment Company Act?

The Court: I want the witness to tell me, if he can, what are the reasons why a reorganized Fidelity couldn't go ahead and sell face amount certificates as any other company could.

Mr. Palmer: Is the Court assuming by that question that the company could qualify under the Investment Company Act and asking the witness to dismiss that from his mind, or is the Court—

The Court: Certainly I am including that it could qualify. That's what I want to know. He says one reason why it couldn't is because it would take a lot of money to create a sales force. I want to know if there are any other reasons. Now, you say public acceptance or non-acceptance, but that applies equally to all companies.

A. I am afraid it doesn't, for the simple reason that the [fol. 3153] hundreds of thousands of lines of publicity that Fidelity has had, obviously it cannot live down unless the element of time continues to irradicate it.

The Court: Your next element is unfavorable publicity in the past?

A. That's right.

Q. Let's see if there are any others.

A. Unfavorable whispering campaigns among those who benefitted by the fact that the Fidelity sales activities became extinct.

Q. I don't know whether I understand that or not.

A. May I tell you off the record what I mean?

Q. Tell me on the record.

A. Let us assume that the company sold in a given area \$600,000 of maturity fund face certificates per month, which would be in the neighborhood of seven million dollars a year. It takes those active, aggressive, highly specialized salesmen out of the field, and in that same area other—now qualified under the Investment Act of 1940—face amount certificate companies are operating. They have taken your

customers away from you; they have started them on a new certificate, where they cease paying on the other, and so on. That is what I am attempting to have the Court under-
[fol. 3154] stand.

The Court: Go ahead, Mr. Huwe.

Mr. Huwe:

Q. So that there are successful face amount certificate companies operating now, taking customers away from Fidelity?

Mr. Palmer: I object to that, your Honor. The witness used that as an example and not as a statement of fact at all. Mr. Huwe should have so understood it.

Mr. Huwe: If he can't use a true statement of fact, what good is his example?

The Court: I overrule the objection.

Mr. Huwe: Now, Mr. Steussy—

The Court: Read the question.

(The question was read.)

A. There are very few operating, and they are not taking anything away from anybody. They are merely, in many cases, I am sure, where the people have discontinued their monthly installments because of publicity; court proceedings, and so forth, if they have money to save, it creates a field and they are going into other methods, rather than discontinuing savings—one of them being Government defense bonds.

Mr. Huwe:

Q. How long has this Government bond been on sale?
[fol. 3155] A. I believe you are familiar with that.

Q. Well, let's have it in the record. You are an expert on these things.

A. Well, the present defense bond, as you know, is created out of and in no wise existed except by series numbers out of the original so-called savings bond. That change, as you know, took place late last year and finally got on sale this year.

Q. Now, do you know how many people are still paying to this day on their Fidelity contract? Do you know how many and the amount?

A. I know how many, if the information I received yesterday is correct.

Q. Do you know the amount?

A. I do not know the amount.

Q. Did you know the amount in September, August, and July?

A. No, sir. I can merely tell you what I was told it was presently receiving monthly on the protected contracts.

The Court: One question, Mr. Steussy. How long have those defense bonds of the Government been sold?

[fol. 3156] A. As defense bonds?

The Court: As savings prior to the change in the name?

A. Well, they came out, I would say, about 1937 or somewhere back there. I think Mr. Jaegerman can tell you exactly. I was very busy with the other selling.

Q. Fidelity had its peak sales after those bonds went on the market?

A. Savings bonds?

Q. Yes.

A. Certainly.

Q. You say there is no difference in defense bonds and the savings plan?

A. Only in face amount, and in some, only in yield, but we are in a different time again. In other words—discussing with you what I have said to one of the gentlemen in the room—the originality of the fact that the Government went into a monthly or a periodic savings plan—the inception of it was beneficial to Fidelity, beneficial to the syndicate, because it indicated that the Government was approving and rather encouraging an orderly program of thrift. Then they turn around and take your program and build it up where the cry is to the point where you get your [fol. 3157] change in grocery stores in stamps.

Q. Did it have the same advantages of the Fidelity plan then as it has now?

A. You mean from an actual, mathematical and actuarial standpoint?

Q. From every standpoint.

A. The answer would be No, from every standpoint.

Q. In what standpoint was there any difference?

A. There was no advertising at the beginning—this who-esale mailing crusade that is going on from coast to coast, and from Alaska to the Border wasn't in effect, and

neither were the banking institutions of the country supporting it with ads in magazines and newspapers, half pages, encouraging thrift, as they are today. The banks were trying to get savings accounts. Today they are telling you to buy defense bonds—entirely changing the situation.

Q. Is this advertising campaign the only difference in the situation of 1938 and now?

A. I am attempting, your Honor, to obviously cooperate with the Court as much as I can—

The Court: I don't want you to cooperate with me. I just want you to testify. I am asking you facts—if there [fol. 3158] is any other difference between the two between 1938 and now, between these defense bonds and the Fidelity contract. If you know, I want you to tell me.

A. There are no mathematical differences that have made any difference at this time than they did when the contract—when the savings bond was previously put on the market.

Q. You said there are some advertising differences. Are there any other differences?

A. Yes.

Q. What are they?

A. Well, for instance, when—and I understand this is pretty general—life insurance companies, for instance, are instructing their agents, when they meet the apparent competitive elements of defense bond buying, they shall encourage not only their buying more, but continue the program they have started, and from the standpoint of patriotism, support the issue of doing your share for America, which is a tremendous thing—favorable to the one and adverse to the other.

The Court:

Q. Is that all? Are there any other differences?

A. Well, there would be—as I just touched upon—with stamps. With the original savings bond, you could merely [fol. 3159] buy a bond and take your money to the post office. You couldn't send money by mail originally, until the latter part of 1940, when they did put an installment and envelope-sending system in effect on the other bond. Now you can go to your Kroger Grocery and buy your groceries, and get stamps in change. The vehicle is now made easier—the difference between buying an icebox and radio for

cash and being able to buy it on the installment plan—an entire difference in selling.

Q. Are there any other differences?

A. I don't think any material or important ones.

Mr. Huwe:

Q. And didn't the Government advertise a baby bond? They sent to you about the same kind of advertising with reference to baby bonds back in 1938?

A. They did not.

Q. You didn't receive any?

A. Not only didn't I receive any, but they didn't send them, for I made myself familiar with them.

Q. You mean to say that they didn't advertise them at all?

A. No, sir; I didn't say that.

Q. Answer my question.

A. I am answering your question.

[fol. 3160] Q. They didn't advertise them through the mail?

A. They did some advertising through the mail. You infer that they were doing as much as they are doing now.

Q. Now, how about the sale of series B of the old Fidelity to people who were physically ineligible for low premium insurance? Would there be competition by low premium insurance in such a situation?

A. That question answers itself; obviously not.

Q. Thank you. And wasn't that a sales feature and factor in the success of series B?

A. It was not.

Q. It was not?

A. That's what I said.

Q. Are you speaking about Wisconsin, or are you speaking about all the states?

A. Speaking about B wherever and whenever it was sold.

Q. You do not attach any importance to the fact that the contract holder received a certain type of protection with reference to completing the face amount of the certificate without having to have a physical examination?

A. Will you read that question, please.

(The question was read.)

A. Very definitely a benefit to the man who bought it.

[fol. 3161] Q. So it was an attractive feature to the man who could buy series B policy who couldn't pass a physical examination for low premium insurance?

A. I don't know what you are trying to ask me. You are trying to tie two things up, but you won't let me answer them separately. I can't answer them together.

Q. You have agreed that there is the ability of a series B contract holder to enter a contract wherein, if he predeceases the face amount maturity date, that face amount maturity sum is paid up for him by some insurance feature?

A. That's correct.

Q. Is that particular feature attractive to a prospect who cannot buy insurance and who is looking at the investment from the standpoint of a savings point of view?

A. Has no benefit at all if he cannot qualify for the insurance.

Q. Does he have to take a physical examination in series B?

A. He does if he has attained the age of forty-nine and a half years, or if the sum is greater than five thousand dollars.

Q. Suppose the sum is less and he is less than forty-nine and a half?

[fol. 3162] A. Then the life insurance company passes upon what they call the medical inspection bureau reports. They rely on the system that the insurance companies use, which is a national method, which is equivalent to a medical examination to a certain extent, equivalent to it to a certain extent, because it is medical information.

Q. To a degree.

A. To a degree.

Mr. Palmer: Mr. Huwe has apparently assumed that if a person goes to a life insurance company and is refused for life insurance, he could automatically walk into Fidelity, and being under forty-nine and taking an amount less than five thousand dollars, sign a certificate that "I have been rejected by the life insurance company and therefore take series B." I don't know whether that is a fact. Before he assumes it as a basis for his questions, I think the witness should—

The Court: All that he has assumed is that a man may be under the age of forty-nine and a half years and want less than five thousand dollars, and not be in a physical condi-

tion to pass an insurance examination, and such a man may get a series B contract. Now that apparently is the fact, with some qualifications, and the witness is going ahead [fols. 3163-3171] and explaining what those are.

A. The first qualification is that the life insurance company issuing the coverage on it always has the right for the request of a physical examination, regardless of age or regardless of the amount. The other—at all times, the method employed by the institution of life insurance is medical inspection reports and the so-called “rate card” which give a complete record of previous applications of insurance, which would automatically mark anyone who had been turned down for life insurance.

[fols. 3172-3180] Q. You thought it was a good idea to emphasize the exacting law of Wisconsin?

A. Very definitely.

[fol 3181] Cross-examination.

By Mr. Ray:

Q. Your experience has been exclusively in selling, has it not, Mr. Steussy?

A. You mean, have I devoted my time to selling?

Q. Yes.

A. Substantially, yes.

Q. As special agent of the Provident Life Insurance Company, you were engaged in selling life insurance, were you?

A. That is correct.

Q. What else did you do besides sell life insurance for that company?

A. I sold annuities.

Q. But you were engaged in selling?

A. Oh, very definitely.

[fol. 3182] Q. What business experience did you have before your connection with the Provident Life?

A. Well, way back in my educational set up I prepared for business by business schooling, and I was in the general mercantile field most of my life previous to the time of entering into the life insurance business.

Q. What business schooling did you have?

A. Well, I finished the public and high schools of my home town community, which was New Glarus, Wisconsin; after that I went to a commercial academy and took a commercial business course.

Q. What was the name of that business school?

A. Capital City Commercial College, still in existence and doing—

Q. Where was that?

A. At Madison, Wisconsin.

Q. How long were you there?

A. The length of time that it took to complete the course—I can't remember at the moment exactly how long.

Q. Was it four or five months?

A. Longer than that; but it wasn't any four or five years, I would say. I can't tell you exactly how long I was there, [fol. 3183] because I took it piecemeal, for one thing, and for that reason the time doesn't follow itself. It isn't continuous.

Q. You did what?

A. I took it during so-called interval periods.

Q. I see. What do you mean?

A. I don't like to testify as to time; it seems that I went longer than I went.

Q. I see. What was your business experience before you got into Provident?

A. I was in the general mercantile business in the rural community with my father from the time I finished school until 1914.

Q. You mean in a country store?

A. I don't mean that—in a chain of stores; five, to be exact.

Q. Grocery stores?

A. Everything from silk shirts down to the buying of hides, groceries; we sold sewing machines, pianos, and so forth—large inventories and a large volume of business.

Q. And you were primarily engaged in the sales of that business?

[fol. 3184] A. I was engaged in buying, went to the market to buy—had a complete general experience from A to Z in the operation of a general enterprising business.

Q. What became of that business?

A. That is partially out of business. The real estate people have now rented it to chain stores mostly; some now owned by my father—and very successfully rented, incidentally.

Q. When did you leave that business?

A. I left when I started to enter business in my own account and went to the city.

Q. When was that?

A. That was in nineteen—just about the time of the other War; I went to Milwaukee and engaged in the mercantile business, specializing in the musical instrument business.

Q. You were still engaged in selling?

A. Engaged in buying and selling, and got in the manufacturing of pianos the following year.

Q. After that, what did you do?

A. Then I continued in that business, because connected with the American Piano Company of New York—represented them in Wisconsin, representing the highest grade, [fol. 3185] together with their cheaper merchandise. At the time the automatic pianos were losing their popularity, I went with the radio business—went into the radio business with Grisby-Grunow in the peak years of 1928 and 1929.

Q. During those years you were principally engaged in selling?

A. I bought millions of dollars of merchandise during that time and beyond the early thirties; bought hardware, wire—everything in the manufacture of pianos; had to do with the financing—had a lot of dealings with financial companies.

Q. My questions were relating to the Grisby-Grunow people. You were principally engaged in selling during those years, were you not?

A. Of course, any mercantile enterprise, everything you buy for it must be sold; otherwise you couldn't economically operate the business.

Q. That has been your specialty—selling?

A. I would say the training of help and executive capacity of a sales organization.

Q. Let us get back to the Grunow business. You were principally engaged in selling radios, were you not?

[fol. 3186] A. The training of salesmen to sell them.

Q. That is being engaged in the selling of radio equipment—is it not?

A. That is right.

Q. From the Grunow people, where did you go?

A. Provident Mutual.

Q. During the years with Provident Mutual, you were principally engaged in selling?

A. Entirely so.

Q. From Provident you went to Fidelity?

A. That is correct.

Q. Have you ever been connected with Fidelity in any way but the selling department?

A. No, sir.

Q. Since you left Fidelity, have you been engaged in anything but the selling department?

A. Yes.

Q. What department?

A. I am on the so-called inter-company meetings that we have. We counsel on all the things; we have advertising—the sales of different departments—

Q. Did you—

[fol. 3187] Mr. Palmer: Let him finish his answer.

A. (Continuing) I obviously discuss investments. I made some commitments for investments, have been on investment committees, and so forth. Those policies, they are all discussed. If you become an executive of an insurance company, your duties are obviously very broad.

Q. Did you not state that you were made a vice-president and put in charge of selling this particular form of contract?

A. Yes, sir.

Q. Isn't that what you have been principally engaged in?

A. Oh, yes; principally, I have.

Q. And that is what you went there to do?

A. Oh, yes.

Q. And it was your experience as a salesman which was responsible for your going to Franklin?

A. That is also correct.

Q. What work have you ever done in any actuary department of any company?

A. Well, actually creating mathematical equations—none; checking them as to salability, desirability, usability

beneficial to the buyer—a lot of it; a lot of it for Fidelity and since—in other words, when new contracts came out, [fol. 3188] the supervisors were the fellows that were asked whether it was salable; they had control of it. There wasn't anybody in the home office—they didn't know “boo” about it.

Q. You didn't do any actuarial work on it?

A. I didn't do any of the mathematical equation work, no.

Q. What did you have to do with the investment policy of Fidelity?

A. Not a thing.

Q. What did you have to do with the investment policy of Franklin?

A. I have nothing to do with the policy. That is established and on record by the State law and the State requirements, and they certainly didn't change that because they found me.

Q. And you have made no changes in investment practices or policies or conditions at Franklin since you went there?

A. I am afraid I haven't.

Q. Did I understand you to say that the reason face amount certificates would not or could not be sold under the Investment Act of 1940 was because the loading charge was only seven cents out of each dollar paid in by the contract purchaser?

[fols. 3189-3202] A. I said the loading charge was too low, and I referred to the seven per cent of the net deposits of the purchaser, which you will find in the law, if you examine it.

Q. Do you mean by that, that only seven cents out of every dollar which the buyer pays to the company can be used for loading, and that seven cents out of every dollar paid in by the buyer is too small to carry on the business?

A. That is exactly what I mean.

Q. Do you want to make any explanation or any amplification of the answer you have just given?

A. I don't think so.

[fol. 3203] RICKARD H. LAURITZEN, called as a witness, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Palmer:

Q. State your name, please.

A. Rickard H. Lauritzen.

Q. Your residence, please?

A. Madison, Wisconsin.

Q. Your occupation or profession?

A. Attorney.

Q. What, if any, official position do you hold with the State of Wisconsin?

A. Senior Assistant Attorney-General.

Q. How long have you held that position?

A. Since March of 1939.

Q. Do you know Mr. James Fleming, the attorney for the debtor?

A. I met Mr. Fleming.

[fol. 3204] Q. And do you know Mr. Allen Messick, Chairman of the Board of Fidelity?

A. I have met Mr. Messick.

Q. During the early part of June 1941, state whether Mr. Messick and Mr. Fleming came to the State of Wisconsin, and in your official capacity, you had a conference with them.

A. They did and I did.

Q. Who else was present at that meeting?

A. Mr. Allen Pflugradt, Chairman of the Banking Commission of Wisconsin, and Robert Reiser of Madison, attorney for Fidelity Assurance Association.

Q. Will you tell the Court what was said at that conference?

Mr. Ray: We object, your Honor.

Mr. Palmer: I was asking the witness to tell the Court what was said at that conference.

The Court: Certainly everything said at that conference couldn't be said by the witness.

Mr. Palmer:

Q. What was stated by Mr. Messick and Mr. Fleming as to whom they represented, if anyone, and their purpose in holding the conference.

[fol. 3205] Mr. Ray: If it please your Honor, I object.

The Court: Overruled.

A. Mr. Fleming first stated that he represented the debtor with respect to the petition filed in this Court for reorganization, and Mr. Fleming and Mr. Messick both stated that they were authorized by the trustee to go out to the various states to ascertain what the attitude of state officials holding state deposits was with respect to those deposits.

Mr. Palmer:

Q. Thereafter was the conversation general, but with reference to Fidelity and its deposit with the State of Wisconsin?

A. It was.

Q. Were you also present at a meeting held in the City of Chicago on Friday, June 13th, about which meeting Mr. Harlan Justice had previously testified?

A. I was—that was the next day.

Q. That was the day following the meeting in Wisconsin?

A. Yes.

Q. Will you tell the Court please what Mr. Fleming said, and first with reference to whom he represented, and secondly, as to his purpose in being there.

[fol. 3206] Mr. Ray: Let the record show another objection.

The Court: Mr. Palmer, was something said without the hearing of Mr. Justice?

Mr. Palmer: No. This is cumulative testimony.

The Court: If there is any controversy, I will permit the question; otherwise I don't see any use to put in this testimony.

Mr. Palmer: Of course, since the Auditor and West Virginia State Court officials are still presenting their case, we have no way of knowing whether or not Mr. Fleming or others will be called upon to rebut the testimony of Mr. Justice thereafter. We were putting in corroborating evidence because of our lack of knowledge.

The Court: Let us see if we can get any statement on the part of the debtor.

Mr. Ray: The debtor doesn't intend to put in any evidence in respect to that question. It doesn't deem it material to any fact.

The Court: Does anybody else intend to put in any evidence on this matter? If not, I sustain the objection on the ground that it is cumulative as to this particular meeting, and we have already had one witness testify [fols. 3207-3208] to that fully, and unless there was something that occurred without the presence of the other witness, I will sustain the objection.

Mr. Palmer: If the witness were permitted to testify he would in substance relate the same thing that Mr. Harlan Justice has related.

The Court: All right.

[fols. 3209-3221] Cross-examination.

By Mr. Ray:

Q. Mr. Lauritzen, is it true that the principal object and the principal inquiries made by Mr. Fleming and Mr. Mesick when they came to Wisconsin was with respect to the sale of securities by the officials of Wisconsin?

A. That was discussed, but other things as well. I can't say—I can't answer as to whether that was their principal object in coming there.

Q. Do you know that that was the matter, in their opinion, which was of primary importance?

A. I don't know, sir.

[fol. 3222] RAYMOND LATTA called as a witness, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Palmer:

Q. Will you tell the Court your name.

A. Raymond Latta.

Q. Where do you live, Mr. Latta?

A. I live at Wheeling at the present time.

Q. And from what place were you summoned to come to this hearing?

A. Plymouth, Michigan.

Q. Were you there on a vacation or a visit?

[fol. 3223] A. Well, it's partially a visit, partially business.

Q. I believe you came here only in response to a subpoena and not voluntarily? Is that correct?

A. That's correct.

Q. Were you formerly employed by Fidelity Assurance Association?

A. Yes.

Q. For how long a period were you employed?

A. I started with Fidelity on February 12th 1941.

Q. And when did you terminate your employment with that company, either under receivership or trusteeship?

A. September 15th.

Q. Will you relate to the Court the schooling or education that you had, Mr. Latta.

A. I studied actuarial mathematics at the University of Michigan from 1929 to 1934.

Q. Actuarial mathematics?

A. Yes, sir.

Q. I presume you were a high school graduate before that?

A. Yes.

Q. After that time did you go into that business?

[fol. 3224] A. Yes.

Q. Could you tell us with what firm you were employed?

A. Well, for a year I was with a life insurance company—1934 to 1935; then in the summer of 1935 until I came with Fidelity I was with a consulting actuarial firm.

Q. Do you care to give us the name?

A. Welch and Baird.

Q. Of what city?

A. Cleveland, Ohio.

Q. State in general what your duties were with that firm.

A. We did actuarial work for various life insurance organizations, and specializing in reorganization of life insurance organizations.

Q. Did you yourself take part or take any part in aiding in the reorganization plan of any life insurance company?

A. Yes.

Q. How many different ones, if you recall, did you take part in?

A. Well, if you take all reorganizations as a class, I would say approximately fifteen.

[fol. 3225] Q. And taking individual or specific ones, how many did you take part in actively? Would it be the same number?

A. Yes, the same number.

Q. Will you tell the Court just what part you took in those reorganization proceedings, and also what part your firm took, and what part was left to others, so that we can get just your background on that.

A. My work with the firm was the supervising of the actuarial work. The firm worked out the reorganization plans and in some instances made the calculations for the valuations determining the equities. I think the calculations would cover most of them, and the plans of reorganization.

Q. Will you tell us whether the reorganizations in which you took part were in any court proceedings or under proceedings of any authorities.

A. Yes; some of them were under court proceedings.

Q. Will you tell us, did you take part in any reorganization proceedings in which the state authorities had charge by statute of those reorganization proceedings.

Mr. Ray: Your Honor, he couldn't reorganize life insurance companies unless the state authorities were interested. [fol. 3226]

Mr. Palmer: I have that in mind. My question was as distinguished between the state statutory authorities and perhaps a state court proceeding; if there is such a distinction, I wanted to determine that matter.

Mr. Ray: If there was, it was a proposition which this witness couldn't do—

Mr. Palmer:

Q. I am asking whether you took part—is my question clear to you?

A. Restate it, please.

Q. Some life insurance reorganizations occur by virtue of creditors or other persons causing court proceedings to be instituted; some occur whereby the state authorities in charge of life insurance by statutes conduct or manage the

reorganization proceedings. Now, I would like, if you could, for you to state if you have been in either or both of those types of reorganizations or taken a part therein.

A. Well, all of those I worked on, so far as I know, came under the jurisdiction of the state authorities. I can't go further on the question.

Q. Now where they were under the state authorities, how [fol. 3227] many of those fifty you mentioned would that apply to?

A. What was that, please?

Q. You said that you worked upon fifty—

A. Fifteen.

Q. Fifteen? Could you tell us how many of them necessarily included working with the statutory state officials of more than one state?

A. No, I don't believe I could state that.

Q. Were there some of them which included working only in the one state and some which included working in one state in connection with other states necessarily involved?

A. That is correct.

Q. In reference to those latter ones, were there more than one of those, that latter type of reorganization, upon which you worked?

A. Yes.

Q. With reference to those, what can you tell us as to whether the statutory officials of the state in which the life insurance had its home office or principal place of business were cooperated with by the statutory state officials in the other states in which the company did business?

[fol. 3228] Mr. Ray: We object to that.

The Court: Sustained.

Mr. Palmer: If your Honor please, we are attempting to determine whether Fidelity could have been—whether the interests properly could have been subserved by State Court proceedings. If we show that in other kinds of somewhat similar proceedings, State Court officials did work and cooperate together to achieve the end, I think that would be a matter that your Honor would be interested in, or if the State Court officials did not cooperate together and the end result wasn't satisfactory. That's what I have in mind.

The Court: When we have evidence in this particular case that the State officials are not cooperative, it seems to

me that testimony that in other reorganizations they were or were not cooperative is immaterial.

Mr. Palmer: If your Honor would refresh my memory as to the evidence that they were not cooperating—I perhaps heard the evidence and don't recall.

The Court: They stated on the record—

Mr. Palmer: I realize that the debtor passed a resolution to that effect, but so far—

[fol. 3229]. The Court: I mean these representatives here, one and all stated on the record that they were not prepared to say that they could cooperate with State Court proceedings. Some of them said they wouldn't cooperate with it; others said they didn't know. None of them, so far as I can recall, said that they would, unless on their own terms. Do you have any difference recollection?

Mr. Palmer: I don't recall the statement of anyone that said they would not cooperate with the West Virginia State officials.

The Court: They didn't state that in those exact terms, that they would not cooperate; but they made statements which the Court could not interpret in any other way.

Mr. Palmer: That is why I wanted this witness to explain, if he could, how the various states do work together, but each retains its own sovereignty and retains jurisdiction over its own funds—for that very purpose—to show where each state has its own deposit and each its own laws, how they do work together in insurance company reorganizations to reach a final result, that they frequently do—and if this witness is familiar with the mechanics of how that is done, I would like it explained to the Court [fol. 3230] and for that reason I think it is material.

The Court: I will let him answer the question as to what the State officials did in these cases.

Mr. Palmer:

Q: Limiting my question as indicated by his Honor, Mr. Latta, would you tell us the mechanizations of how the various state statutory authorities worked together, if they would, to achieve an end result of a reorganization of a life insurance company with which you were familiar.

The Court: Your question is still objectionable, because you are bringing in the element of working together, whereas that element is not in this case.

Mr. Palmer:

Q. Will you tell us how they did work?

A. As a rule, the state in which the company was incorporated held—you might say—held supreme; in other words, the other states left it up to that state primarily, because they first had to have their approval on any reorganization plan.

The Court: I will have to rule that out.

Mr. Palmer: I was going to ask a little further. Will your Honor permit me?

The Court: All right.

[fol. 3231] Mr. Palmer:

Q. Mr. Latta, did the other states other than the home office state of the company turn over their deposits to the home state of the company or did they retain those in their own state?

A. I would have to qualify that statement. I have seen it both ways. I have seen them turned over after a a period of time, depending upon the working out of the plan. Then I have also seen them where they did not turn them over until forced; in other words, they didn't do it voluntarily.

Q. Prior to the adoption by the home office state of a definite plan of reorganization, did they ever in any case turn over the assets to the home office state?

A. I can't answer that question.

Q. Could you answer it generally or not?

Mr. Ray: If he can't answer, he can't answer.

A. It is not clear enough to me.

The Court: That is a question that can't be answered generally.

Mr. Palmer: You are right, your Honor.

Q. In the majority of cases that you worked on, what can you say as to that?

A. I don't think the number is sufficient to even answer [fol. 3232] that.

Q. What can you say as to whether or not there were conferences between the officials of the home office state and the statutory officials in other states leading to the working out or rejection of a plan by the home office state?

A. There were none to my knowledge.

Q. I beg your pardon?

A. On the plans I worked, none to my knowledge.

Q. After the home office state had worked out a plan, was it adopted by the other states or rejected by them in their discretion?

A. Yes.

Q. What can you say as to whether or not the majority of the states adopted the plan that had been proposed as satisfactory to the home office state?

A. I don't think I get that question clear enough.

Q. If a plan had been made by the home office state, it was then submitted, as I understand, to the officials—proper officials in the other states. Is that correct?

A. In some instances.

Q. In those instances, was it submitted to them for the purpose of agreeing to it or criticising it or rejecting it, or what was the purpose?

[fol. 3233] A. Depending upon whether the company wanted a license in that state, as a rule.

Q. If the company wanted to renew its license or a new license in that state, it was submitted to the officials in that state. Is that correct?

A. That is correct.

Q. And they went over the plan to find out as to whether it was a proper plan for use in their estate. Is that correct?

A. Yes.

Q. If they determined it to be a proper plan for use in their state, they so informed the state of the home office; otherwise they informed them that it was not a proper plan.

(No answer.)

Mr. T. C. Townsend: I object to this line of testimony. It is too general to be of value.

The Court: Overruled.

Mr. Palmer:

Q. Now, of the fifteen companies that you worked upon for reorganization, how many were successfully reorganized through state statutory proceedings?

A. I can't interpret that question exactly. It's too general for me.

Q. You were working on fifteen companies, helping to try to reorganize them. Is that correct?

A. That's correct.

Q. At the time you left your employment, had reorganization been completed in any of those fifteen different reorganizations you had been working on?

A. Yes.

Q. How many of those had been completed?

A. Approximately twelve, I would say.

Q. Of the three remaining, were they still being worked upon, or had they been finished and been found to be impossible to reorganize?

A. I don't know that we can interpret reorganization—it's a rather broad statement. Reorganization, your Honor, to me means changing of a company's complete plans—

Mr. T. C. Townsend: We didn't hear that.

A. (Continuing.) Reorganization means changing of the company's complete plans, and possibly equities of the contracts involved. In some cases, some reorganization plans require years to work out, or at least to tell the tale. To say whether one is successful or not is rather a broad [fol. 3235] statement, unless defined. If you define what you mean I might—

Mr. Palmer: I understand what you mean.

Q. Had your work been completed in those other three in the company with which you worked?

A. Yes.

Q. And was the plan upon which you had worked being put into effect and operation?

A. Yes.

Q. On any of the companies that you ever worked—and I am speaking of life insurance companies—towards their reorganization, was it ever found to be impossible to effectuate a plan or method of operation?

A. That is rather broad.

Q. Sir?

A. That's rather broad.

Q. Will you narrow it as much as you wish and tell us how you are narrowing it before you answer.

A. Before a plan is put in effect, it is pretty well laid out.

Q. Yes.

A. (Continuing.) And, on the contrary, if the plan isn't, [fol. 3236] we probably didn't work on it; we couldn't have worked out a plan if it hadn't been put into effect. When

we entered the work, some of those things probably had already been determined.

Q. Now, of the fifteen companies that you worked actively upon, and particularly the twelve that you say were more or less completed, how many of those twelve became operating companies again in the sense that either due to themselves or to someone taking them over, they kept on going in the life insurance field?

A. Your question—one part contradicts the other. If they are turned over they don't keep on going.

Q. The company itself does not?

A. No.

Q. That part of it which was a part of the new company is being operated. Is that correct?

A. That's correct; that's it. If they are turned over, the equities are preserved up to that date, but they don't continue to operate as a company, so I can't answer your first question for that reason.

Q. Mr. Latta, would you explain to us the mechanics, if it isn't too broad again, of attempting to reorganize a life [fol. 3237] insurance company; what is involved and what you must look for and what you must attempt to do.

Mr. Ray: That's going too far afield.

The Court: Sustained.

Mr. Palmer: If your Honor please, that is preliminary to later questions so that the Court and counsel will understand the definition of terms that may later be inquired about.

The Court: I think we understand it. If we don't we will ask you about it and we will bring it up at that time.

Mr. Palmer:

Q. Of those twelve companies of which you have been speaking, how many were put upon or attempted to be put on a plan whereby the company itself would be rehabilitated into a new company, and how many were put into the category of a new company absorbing it?

Mr. Ray: I think we have heard enough about those twelve insurance companies. We don't know what their problems were, what the conditions were. There is nothing to show that the conditions were like conditions in connection with this company. What we are interested in is the

jurisdiction of this Court to reorganize Fidelity, but, not [fol. 3238] about what this witness did with some twelve companies from 1935 to 1941. We admit he is an actuary, and he has had broad experience. Let's get down to the jurisdiction of this Court in connection with Fidelity.

The Court: Overruled.

Mr. Palmer: Will you read the question.

(The question was read.)

A. I can't answer that question. There are too many phases that I would have to discriminate in order to answer that question.

Q. Were there some in each category?

A. You might say if you have twelve companies you might have twelve categories.

Q. Now, did you make a study of Fidelity after you came to Wheeling?

A. I studied phases of it.

Q. And what phases of it did you study?

A. That's a rather broad—

Q. What is that?

A. That is a rather broad question.

Q. Did you study them from an actuarial end?

A. Some of them, yes.

Q. What else did you study?

[fol. 3239] A. Some of the financial statements—phases of the statements; some of the contracts—some phases of the contracts.

Q. Did you study any selling ends at all?

A. Very little.

Q. Did you study the investment end of it?

A. Very little.

Q. What was the purpose of your study?

A. At various times, the phase of determining the condition of the company. It changed very often—the purposes were changed very often due to the status of the company.

Q. Were you also attempting to make a study to see if Fidelity could be rehabilitated?

A. Yes.

Q. Did you formulate either roughly or fully any plans or ideas as to how far Fidelity could be rehabilitated?

A. I formulated some general ideas. I couldn't say plans—no.

Q. Did you formulate or attempt to formulate any plans whereby Fidelity would be rehabilitated or could be started again solely as a face amount certificate company?

[fol. 3240] Mr. Huwe: I object. His testimony has been that he formulated general ideas, and couldn't say they were plans. That question infers that he went further and formulated plans.

The Court: Mr. Palmer, you are asking him now whether, according to his plan, his idea—whatever you may call it, it was possible to rehabilitate Fidelity solely as a face amount certificate company?

Mr. Palmer: Yes.

The Court: What pertinency do you think that sort of exclusive question has here? Is it your idea that the only way Fidelity can be reorganized under Chapter 10 is to reorganize it solely and only as a face amount certificate company?

Mr. Palmer: No, your Honor. My idea is that Fidelity can never be reorganized solely as a face amount certificate company, and I want to show, so we can get that feature out of the road—and then investigate the possibilities of some plan that might be possible.

The Court: That might be pertinent at some later date; but now the narrow question is whether it would be reasonable to suppose that if it were reorganized, it could be re-[fol. 3241] organized at all, whatever may be the means or methods.

Mr. Palmer: In my examination I am attempting to investigate that by breaking it into the various categories in which it is possible theoretically to reorganize it, and examine each one to see whether, as the Court has suggested, it is possible to be reorganized at all; then, if need be, we can take them into groups. To get up to that idea, you must take it into the common or basic categories in which Fidelity could ever operate in again. We can exclude, for instance, that Fidelity could be reorganized to make fire engines or airplanes. Then as to the question of whether Fidelity could be reorganized as a bank, that is too far afield. Then we come to a face amount certificate company that would sell term life insurance, a company that would sell a combination of various life insurance. In order to test the idea whether it can be reorganized at all, it has been my idea that we should take each of the various cate-

gories and see if it could be put into that category solely.

The Court: With that understanding, go ahead.

Mr. Palmer:

Q. Did you investigate or attempt to determine whether [fol. 3242] Fidelity could be reorganized solely as a face amount securities company?

Mr. Ray: I don't think he is qualified as having sufficient experience with face amount certificate companies and with all the phases of such a company, and with all the statutes which regulate such a company, to be able to make such a study.

The Court: It seems to me that so far, his qualifications have been limited in his examination to familiarity with a reorganization of insurance companies.

Mr. Palmer: My question was only to ask him if he had made any investigation into that possibility. I don't know that he has made it.

The Court: Unless he is qualified in the first place, then whether he made an investigation would be immaterial, because anyone of a number of persons you may bring here might have made an investigation; still, that wouldn't make his testimony relevant.

Mr. Palmer: Let me see if I can understand the position that the attorney for the debtor has taken. This morning he objected to asking the witness questions about a face amount certificate company, because the man wasn't an actuary, and now we bring in an actuary, and he says we [fol. 3243] shouldn't ask an actuary questions about a face amount certificate company. May I ask whom we should bring here? Various directors of the company who had no actuarial experience? Mr. Burt, who had no selling experience and testified in full how easily the company could be reorganized? Men of that sort?

Mr. Ray: Mr. Burt was president of this company for a great many years. It would be presumed he should be familiar with every phase of it. I think Mr. Palmer would have been, and I might have been.

The Court: When an objection is made, I feel compelled to rule on it, but I think the law requires, and I believe this witness ought to be qualified as to some familiarity with face amount certificate companies before we proceed along that line.

Mr. Palmer:

Q. Mr. Latta, have you studied and did you become familiar in your work with what are known as face amount certificate companies, such as Fidelity had been?

A. Phases of it, yes.

Q. Which phases of it?

A. The mathematical phases.

Q. Speaking from the mathematical end of it only then, [fol. 3244] did you investigate or did you attempt to ascertain whether Fidelity could be reorganized as a face amount securities company purely from a mathematical viewpoint?

Mr. Ray: I submit that that doesn't qualify him.

The Court: It depends on what Mr. Palmer means by "purely from a mathematical viewpoint." Do you mean by that, whether any actuarial plan could be figured out whereby a face amount securities company could operate?

Mr. Palmer: I was asking if he had considered that or thought about it. I haven't even come to the question that Mr. Ray is objecting to. I don't know the answer to that yet.

The Court: Will you read the question.

(The question was read.)

The Court: The question was as to the meaning of reorganization. That is a broad term and pursues in the Court's mind, for purposes here, the actual operation of the company after it is set up. If that question is limited to simply a consideration of whether or not a mathematical or actuarial basis can be arrived at for such a company to proceed on, then it is all right.

Mr. Palmer: I think your Honor is right. If your Honor will hear the question read again—if he made any investigation [fol. 3245]; my question is to find out what he did himself towards investigating these conditions.

The Court: All right. I will let him answer the question.

(The question was read.)

The Court: Answer that Yes or No.

A. With the word "reorganization" there, I can't answer the question—with the word "reorganization."

Mr. Palmer: Strike the word "organization" from it then.

Mr. Jaegerman: Then you don't have any question.

Witness: Pertaining to reorganization—it is too broad.

Mr. Palmer:

Q. Did you investigate or make an attempt to find out about face amount securities as sold by Fidelity, from a mathematical viewpoint?

The Court: I didn't hear that question.

Mr. T. C. Townsend: I object. Read the question for the Court.

(The question was read.)

The Court: I overrule the objection.

A. Face amount securities? You mean contracts?

Mr. Palmer:

Q. Face amount certificates.

[fol. 3246] A. Yes, I investigated them.

Q. Did you make a study of Fidelity with the view in mind of the possible transformation of Fidelity into a life insurance company?

A. In general—yes.

Q. Did you make a study of Fidelity, in general, with a view of an attempt to rehabilitate that company into a going concern?

A. Yes.

Q. Will you tell the Court generally what you did along those lines?

A. My work along those lines was in collaboration with certain other officers in a plan that they had instigated, and it only dealt with the handling of equities of the contract holders.

Mr. T. C. Townsend: I didn't hear that. Will you read the answer, please.

(The answer was read.)

Mr. Palmer:

Q. This work was then with the equities of the contract holders? Is that correct?

A. That is correct—limited to this plan that we first talked about.

[fol. 3247] Q. Yes. Now, what did you do with reference to ascertaining what could be performed with the equities of the contract holders?

A. That's too broad.

Q. Will you tell us what you did with reference to that particular phase of your work?

Mr. Ray: I don't think that is pertinent.

The Court: Overruled.

A. I can't answer that question.

The Court: Can't you explain what you did? That is what he is asking now—what you did.

Witness: To this plan?

The Court: The question is what you did with reference to any examination of the equities of the contract holders in framing any plan as a result thereof, or any skeleton of a plan, or ideas for a plan.

Witness: There were very many skeletons made, and as I said, my work was only in collaboration in connection with how the equities—whatever they may be—could be used in applying toward the life insurance annuity contract.

Mr. Palmer:

Q. Did you attempt to work those equities of the contract holders into any form or plan for face amount certifi- [fol. 3248] cates?

A. No.

Mr. Huwe: I thought he said life insurance annuities.

The Court: He did.

Mr. Palmer:

Q. I hand you herewith two volumes, one marked "Uniform Plan," and one "Graduated Plan," and ask you if you have seen those before?

A. (Examining books:) I have seen parts of them, yes.

Mr. Palmer: Will you mark these for identification, please.

Exhibits 111 and 112.

The books referred to were marked for identification respectively as above indicated.

Mr. Ray: I am going to object to the use of these because they are dated before this actuary became connected with the company.

The Court: Let me take a look at them. (The reporter handed Exhibits 111 and 112 for identification to the Court.)

Mr. T. C. Townsend: I would like to find out where these files came from. May I ask, Mr. Palmer, where did you get them?

Mr. Palmer: I think it will be disclosed in proper [fol. 3249] time.

Mr. T. C. Townsend: From the legal files of Fidelity?

Mr. Palmer: I said, I think it will be disclosed at the proper time.

Mr. Ray: Now is the proper time.

The Court: Before ruling on the admission of these, have you offered them?

Mr. Palmer: No, sir. There was an objection to my using them.

The Court: You have had them marked for identification. Are you going to ask a question about it?

Mr. Palmer: Yes, sir.

The Court: Ask your question and see if there is any objection to it.

Mr. Palmer:

Q. Handing you first Exhibit for identification No. 111, will you tell us with what parts of that you are familiar?

A. (Examining exhibit:) I am not familiar with any of the details of this particularly, except this is the part, as I recall—it is a plan in which, as I stated before, that I went into and helped collaborate with upon the plans of any equity—whatever it may be. I made a statement similar [fol. 3250] to that effect.

Q. And the same statement applies to both plans?

A. Yes, sir.

Q. Now, let me ask you this, as a general question: Is it true that the equities of the contract holders of Series A, B, and D were in proportion much greater than the equities of the contract holders of the older series of contracts?

A. What do you mean by "equities"?

Q. The same thing you do, I hope:

A. I don't understand the question, I am sorry.

Q. You spoke of equities—

The Court: Do you mean greater in proportion to 100%?
Mr. Palmer: Yes, your Honor.

A. They have a higher percentage of equity, yes; as far as the solvency of the company, the general statements show that the A, B, and D—the degree of solvency is much higher.

Q. In working out any procedure or plan having to do with the equities of the contract holders, tell the Court whether or not the fact of that unequalness of the equities in proportion to solvency of the company was a barrier or hazard that was blocking your efforts.

[fol. 3251] A. In this plan, you mean?

Q. In this or any other plan.

A. I thought you were speaking of these. That's a question we didn't know the answer to.

Q. It was a hurdle that you didn't know how to get over. Is that right?

A. As far as the exact equities, their percentage have never been determined. Various estimates have been made, but no—

Q. Did you ever attempt to find those exact equities?

A. I have worked towards them roughly.

The Court: In any reorganization, whether of this kind of company or a life insurance company, don't you ordinarily find that different creditors or policy holders or contract holders have different equities, and some of them are more nearly 100% than others?

A. Well, as far as life insurance, the only place I found that where it varied between any two contract holders, in life insurance, the only place I found that it varied was in the fraternal life insurance company.

The Court: Have you reorganized some of those?

A. That is the only place you have a general fund—a [fol. 3252] life insurance company—just one fund.

The Court: If these varying equities are determined by a Court having the power or authority to do so, then it becomes comparatively simple to work them into a plan, isn't it?

A. Yes, as far as handling—handling of the equities and use of the equities—you can figure out the equities, whether it is one dollar or one thousand or one hundred per cent.

Mr. Palmer:

Q. In any attempt, however, to rehabilitate the company before there were receivership proceedings, the fact that, let us say, the B-fund had a 95% equity and the special annuity had, let us say, a 25% equity, was a difficult matter to work out. Wasn't that true? I mean, as a practical matter?

A. My experience there was they never determined what amounts each fund had. As far as working out a plan is concerned, it offered problems to what we were working toward, because we had no assumptions to make toward determining the equity of each fund.

Q. Let me develop that a little more fully. You attempted to find out how much equity or cash against liability each [fol. 3253] policy holder of each series of contracts would have. Is that correct—roughly?

A. Worked out statements of that nature revealing information of that nature, with innumerable assumptions made.

Q. What was that?

A. We tried to develop figures along that nature, with—making innumerable assumptions—a number of them, I mean.

Q. Part of the trouble was that you had loans between funds and transactions between funds and as shown by the books of the company. Isn't that true?

A. Yes, sir.

Q. And you would have to assume in some instances that the loan would be paid back by one fund to the other fund before you would work on it. Isn't that right?

A. We made various assumptions.

Q. Yes. That was one of the assumptions you made.

A. Yes.

Q. And in other assumptions, you just took the reserve as shown by the books of the company as belonging to that fund, without paying back any of its loans in other funds and worked on that assumption.

[fol. 3254] A. We made various assumptions along that line; yes.

Q. You had no way, prior to receivership proceedings being brought, of determining which of your assumptions would be lawfully and legally correct?

A. Did you put a date in there? I can't answer that with a date.

Q. You had no way of determining that any of your assumptions was lawfully and legally correct?

A. I haven't heard the answer as yet, if that is what you mean.

Q. By that you mean the answer to the question is that you had no way of determining it?

A. That's right.

Q. Now, with what other officers of the company did you work?

A. I worked with the president, vice-president and secretary, chairman of the board, and other vice-presidents.

Q. Did you work any with the firm of Koontz & Koontz, or any of the members thereof?

A. On a plan?

Q. Yes.

A. No.

[fol. 3255] Q. Did you submit any plans to them after you had finished, or did you discuss with them any ideas?

A. I discussed some ideas with Mr. Thomas, who was the receiver.

Q. Prior to receivership, it has been testified here that you and Mr. Tom Foulk and Mr. Risley attended a conference in Mr. Koontz' office.

A. We discussed some phases of reorganization.

Q. At that time had you achieved any plan which could have been presented to contract holders?

A. No.

The Court: He says he hasn't yet, Mr. Palmer.

Mr. Palmer:

Q. Did you have tentative ideas or workings on which you hoped that a plan might be built at the time you had a conference in Mr. Koontz' office?

A. We had some ideas that we hoped might work out—yes.

Q. Now, these two volumes which I have handed to you, Exhibit 111 and 112, can you tell us whether or not they were prepared as tentative or rough working plans upon which it was hoped that a plan could be worked out?

A. It was rough work, is my understanding. These were drawn up by various officers of the company to be

[fol. 3256] presented to the S.E.C. in a hearing held there on April first to discuss the rough ideas of a plan that might work out.

Q. These were not thought to be ~~for~~ meant to be any finished product or plan?

A. No. That is my understanding.

Q. Yes. They were merely ground work upon which it was hoped that ideas could be based to build a finished plan?

A. That's correct.

Q. Can you tell us, if you know, where the figures used here in both of these Exhibits 111 and 112 came from?

A. I didn't see the figures in there before they were bound in the volumes.

Q. Will you tell us, can you point out what, if any, particular parts of it you worked upon?

A. I testified before that I only collaborated.

Q. Yes. Well, excuse me. Can you tell us upon—

A. By collaborating I mean discussing with the officers as to what—as to the phase discussed in there.

Q. In other words, there wouldn't be any particular part that you could say, "I worked with the president in pre-[fol. 3257] paring this particular page" or something like that?

A. No.

Q. It would be a joint or group work of yourself and a number of officers in collaboration and discussion of ideas, and these would be the rough setting down of the joint thought?

A. That's correct.

Mr. Palmer: With that thought in mind, your Honor, I believe they became relevant to be offered in evidence now for that purpose only, and not that they represent the facts or figures set out there are correct, but only to show a—what the witness has called it—rough working sketch or outline jointly contributed to by the various officers; as I say, not for the purpose of showing that any of the figures or tables represent correct figures or purport to.

The Court: Is there any objection to the offer of these two booklets?

Mr. Huwe: Your Honor, we object and will say that only the parts which Mr. Latta can particularly point out as his contribution should be admitted and not generally.

Mr. Ray: It's quite hard to know what to say about a thing of that kind before you know what is in it.

[fol. 3258] The Court: As I understand it, the offer is for the purpose of showing that there was a plan, or maybe more than one plan, of reorganization being considered prior to receivership, and that these booklets outline the plans that were being considered.

Mr. Palmer: There were two different plans which handled the equities of the contract holders in different respects. Am I correct in my distinction of that, Mr. Latta—uniform and graduated plans? Each handled—

Q. You mean handling or allocating?

Mr. Palmer: Allocating equities.

A. Yes.

Mr. Ray: I am inclined to think that they are relevant.

Mr. Jaegerman: If I understand Mr. Palmer's offer, it is hardly necessary to have them in—just to show that there was a plan considered.

The Court: Then this is the plan.

Mr. Jaegerman: Do you offer it for its contents?

Mr. Palmer: To a limited extent. I am not offering that the figures are correct or that they represent the accurate figures of what they purport to represent.

The Court: I will permit them to go in.

[fol. 3259]

Exhibits 111 and 112

The books referred to were admitted in evidence, having been previously marked, respectively, as above indicated. The same are attached hereto as a part hereof.

Mr. Palmer:

Q. Now, Mr. Latta, you recall that the state receivership proceedings were brought on April 11th, 1941?

A. Approximately that date, yes.

Q. And you further recall, do you not, that Mr. Ross Thomas and Mr. Isaiah Smith were appointed State Court receivers?

A. Yes.

Q. And you were an employee under that receivership?

A. Yes.

Q. Did you continue the work which you had been doing prior to receivership in attempting to work out the equities and the allocation of them towards the general idea of pre-

paring a plan of rehabilitation of Fidelity either yourself or in collaboration with others?

A. Yes. We took some steps along that line—yes.

Q. Did you go so far as to put into a rough plan some of your ideas in that regard? (Handing paper to witness.) [fol. 3260] A. Examining paper:) This doesn't apply, in my opinion, to the last question.

Q. To what does this paper which I have just handed you apply?

A. That applies to a memorandum on ideas that might be applied to some plan of reorganization of Fidelity under the State Court. The last question, as I recall it, referred to equities.

(There was a discussion off the record.)

Mr. Palmer: I would like this marked for identification.

Exhibit 113

The paper referred to was marked for identification as above indicated.

The Court: May I see that, please.

(Mr. Palmer hands exhibit to the Court.)

The Court: From my brief examination of this paper that you handed me, I presume that you are undertaking to show that there was a plan being developed under the receivership which had some fair possibilities in it. Now, you have also taken the position, as I understand it through this litigation, that for the purposes of good faith of this petition, there is no feasible plan of reorganization under [fol. 3261] Chapter 10. To proceed with this, I would like you to develop, if you can, any reasons why there would be a feasible plan under the state procedure and none under Federal procedure.

Mr. Palmer: I had that intention with this witness to develop that. Might I also state that I think, as stated before on the record, that it is the opinion of myself as counsel that while a life insurance plan is feasible in the State Court, it is not feasible in the Federal Court because of my own personal view of the law that this Court cannot reorganize Fidelity into or keep it as an insurance company for the reason that I think this Court has no jurisdic-

tion to give birth or to help grow an insurance company where it cannot bring it its demise or obsequies.

The Court: You think that because this Court can't be an undertaker, it can't be an obstetrician?

[fol. 3262] Mr. Palmer: We would like to introduce this Exhibit 113 in evidence for the same purpose that the others were introduced.

The Court: It may be admitted.

Exhibit 113.

The paper referred to, having previously been marked as above indicated, was admitted in evidence. The same is attached hereto as a part hereof.

Mr. Palmer: Exhibit 111 and 112 apparently show that some of these figures were prepared prior to your coming to Fidelity. Will you tell the Court about that, why they appear to be that way, and whether this is the actual thing that you worked on.

[fols. 3263-3264] A. They are the plans, as I say—not working on—but I collaborated on; the figures that were explained to me were based upon statements that were prepared as of December 31st. The plans, as I recall, were brought together some time during the month of March, but the figures were on the basis of some statement prepared as of December 31st, of which I took no part in.

[fols. 3265-3269] Q. From your experience and study, Mr. Latta, if there had been a rehabilitation of another face amount securities company through statutory or court proceedings, would you have known of that fact, of the conversion?

A. Not unless it was converted into a life insurance company; otherwise I would have no reason to pay much attention to it.

Q. Do you know of any such conversion into a life insurance company?

A. I don't know of any, no.

[fol. 3270] Mr. Palmer: I will make an offer. When the witness conversed with me, he expressed the opinion that [fol. 3271] this company could not be rehabilitated in the Federal Court because he knew generally of the mail sent to contract holders, particularly the older series, and it had been returned because the person was either dead or was not able to be located, and that returned mail was in such a proportion to indicate that two-thirds of the contract holders, particularly the older series, could not express their desires one way or the other.

Mr. Jaegerman: I think Mr. Palmer knows that under the Act, it is two-thirds of the creditors who filed their claim; if they aren't located to file their claims—

Mr. Palmer: I know; what I wanted to make was an offer into the record, and I have made that offer.

Mr. Huwe: I move that it be stricken on the ground that it involves a conclusion of law for which this man is not equipped to give such an opinion to Mr. Palmer, to be second-handedly proffered into the record.

The Court: It has already been stricken, but I will permit it to be proffered on the record.

Mr. Palmer:

Q. Mr. Latta, is it not true that before it can be determined whether or not any plan can be made, that the first thing that must be ascertained by any Court is the equity [fol. 3272] of each contract holder.

The Court: That question is objectionable because it calls for an opinion on the part of the witness as to what the Court would be required to do. He is not qualified as to that.

Mr. Palmer: This is as to a practical matter, not as to a legal matter.

The Court: You asked what it was necessary for the Court to do as prerequisite to a plan.

Mr. Palmer:

Q. Before any plan can be attempted to be formulated by anyone, is it not true that the exact amount of the assets of the company would have to be ascertained?

A. No, I don't think so.

Q. You would have to obtain approximately the exact amount of the assets of the company?

A. Before any specific plan applying to contract holders—naturally you would have to determine the amount of equity that had to be applied to the plan.

Mr. Palmer: That is what I am getting at.

Mr. Ray: You wouldn't have to determine what they had at all under any circumstances.

[fol. 3273] (There was a discussion off the record.)

Mr. Palmer: So that the first step will necessarily be to determine approximately the assets? Is that correct, Mr. Latta?

A. I don't know what you mean—first step. That would have to be done before you could offer something definitely to the contract holder. I don't see that that would be the first step toward a reorganization plan. "Reorganization plan" is a rather broad term. It is like speaking of the whole government.

Q. Then you would have to ascertain the equity of each contract holder in the assets? Is that true—that would have to be determined?

A. Will you restate that, please.

Q. You would have to ascertain the equity of each contract holder in the assets of the company? Isn't that true?

A. It is part of the plan, in my opinion. You would have to do that before you could apply any equities to the plan; that depends on your definition of a plan.

Q. Now, in Fidelity, is it not true that you have questions—I am not stating that you may know the answers [fol. 3274] to or that you may not—but you have questions which involve the various series of contracts, and the relationship of the contract holders of each series to the other, as you have previously explained. Isn't that true?

A. That I have explained?

Q. I am sorry; I don't hear you.

A. You say, that I have explained?

Q. Yes. Didn't you explain that?

A. You are talking about the solvency of each fund?

Q. Yes.

A. Yes, so far as—as far as mathematically speaking, you cannot determine the exact solvency of any fund due to the problems that are presented, you might say.

Q. Isn't it true that until there has been a decision of law, there arises a problem concerning the deposit of each state as regards to the contract holders of that state?

A. I can only answer that broadly, and that is, that naturally anything that an actuary can work out is only an assumption. So far, no definite answer has been given to me whether the location of assets mean anything, or how to consider them in making a statement. It has all been in a memorandum form.

[fol. 3275] Q. If it should be determined by a judicial body or proceedings that all of the assets could be put into one jackpot and divided among the contract holders in proportion to their own claim, you would have one method of calculating, whereas if you determine it according to series claims, there would be a different method of determination. Is that correct?

A. Naturally, if you consider each fund separately, it would be different from considering all funds in one jackpot.

Q. If besides that, you considered that in each state the state depository fund bore a different degree of solvency to that of every other state, if it should be held that each of those state depositories is a separate fund, that would again complicate your problem to that greater extent. Isn't that true?

A. Naturally you would have different categories, if you take into consideration the various state deposits.

Q. And no actuary could work out a plan until those questions had been legally determined. Isn't that true?

A. A plan would mean nothing with only assumptions. We have made assumptions. Naturally we have had no [fol. 3276] answers—as I have stated several times.

Q. You would need a legal determination of those questions that I have been discussing with you just recently before you could actually put some base under your assumption?

A. Yes.

The Court: I believe Mr. Palmer may not have understood the witness in some of his previous testimony. I understood him to say that there is a difference between devising a plan and then working out that plan, and that it is possible to devise a plan even before the equities are determined or the legal principles relative to the various funds are determined; but that before the plan is put into operation, they would have to be determined. Is that correct?

A. Yes.

Mr. Palmer;

Q. And it is further true, is it not, that in order to help a person to determine whether they would like that plan, you would have to solve these difficulties that I have been talking about in order to let them know whether they were getting 100% or 50% equity. Isn't that correct?

The Court: That is a legal conclusion to be determined [fol. 3277] by the Court.

Mr. Palmer: I suppose it probably speaks for itself.

Q. In the various ways of determining equity—you would have to work them out in their various funds in order to let each contract holder see how he would stand in reference to any particular fund before he could determine whether he would like that plan?

The Court: That's obvious.

A. Yes.

The Court: The distinction that is in my mind—if you want to clear me up I would like you to do it—the distinction is that there may be a plan, and a feasible plan, under the contemplation of Chapter 10, and yet at the same time, we may not know in advance what the equities of the various contract holders are, but the equities, when determined, can be fitted into the plan that is already there.

Mr. Palmer: With this exception: There can be a plan, but I doubt whether there can be a feasible plan in view of what I have been saying, because the Court would be unable to determine whether the plan would give any likelihood of being accepted, for if the old series of contracts [fol. 3278] were going to get nothing back, and A, B, and D were to get 100%, the Court would very probably know that the holders who were going to get nothing would say they refuse any plan whereby the A, B, and D series were entitled to get 100% back; but on the contrary, if the plan indicated that they get back 80% as well as the old series were to get 80%, then the holders of A, B, and D might be said to say that they would refuse that until that was determined—so that with the exception of the question of feasibility, I believe your Honor is right that a plan can be worked before the equities are determined; but until the equities are determined, it is impossible to say it is feasible, because as I understand feasible—it means acceptable and workable—with the equity holders.

The Court: This Court has already indicated that there wouldn't be any plan considered at all except one that would give each contract holder his full equity. Now then, if the contract holder or group of them were advised that it had been decided his equity was 80% or 100%—now here is the plan into which this equity of 80% or 100% is fitted—then it just seems to me at this stage that there wouldn't be any question there as to whether or not that contract holder [fol. 3279] would accept or refuse that plan on any ground, because when it is presented to him, he knows what equity the Court has determined he is entitled to—then it seems to me that this question that you are bringing in has no place.

Mr. Palmer: Let me explain it this way, your Honor, more practically. One of the two older series owes another series certain money, evidenced by a note. Now suppose the Court would hold that the series which owes the money—the contract holders of that series were entitled or had a lien on that part itself. They didn't have to pay back that note, but that the other series just came in as a general creditor behind those contract holders. Now, in that case, it would mean that the holders of contracts in that fund would get about thirty to fifty cents on the dollar, and the fund to which the money was owed would get, say, eighty to ninety cents on the dollar. Now if, on the contrary, the Court would determine, as a matter of law, that the fund which owed the money should pay it back first, then the holders of the fund that owed the money would get nothing at all, and the holders of the fund into which the money would be paid would get one hundred cents on the dollar. Those [fol. 3280] getting nothing would reject such a plan.

The Court: Suppose the Court would say, would you approve of a plan or reorganization under which you get 80% or would you prefer to have the entire matter liquidated.

Mr. Palmer: Now, in answer to that, in the first case, where the contract holder got 80% by reason of the fund not being repaid to it later in the series—the B fund—then that contract holder will say, "I am only going to get 80%. I might as well take a chance on that 80%, and it might work out." If the Court says, "I will require that fund be paid back," and the man says, "I am going to get 100%. I am going to get it out now, because I have one hundred cents on the dollar and will keep it, rather than gamble on

a new company; but if I am only going to get eighty cents or ninety cents, I may take a chance on getting more, although I realize the Court will give me everything I am entitled to."

The Court: Suppose the Court should approve of a plan of paying off, and going ahead with some reorganization and then continuing with the other?

Mr. Palmer: Then we would be back to the State Court [fol. 3281] because if two-thirds of these groups don't agree to the plan, and the plan merely says we are going to liquidate—

The Court: It depends on what you call "groups."

Mr. Palmer: If your Honor please, I have contended from the start, if the Court is going to say, "Fifty per cent of you can get paid off in cash—now take the other fifty per cent into reorganization"—that that's what we could have done and intend to do in the State Court; and that is what this Court isn't permitted to do, and one of the reasons I object to the Federal Court jurisdiction. Two-thirds of the group must agree to the plan. If fifty per cent say, "We want cash," and whoever is in charge says, "We will give you cash," and the other fifty per cent says, "We are willing to reorganize"—that is what we could do in the State Court, and I don't believe this Court—

The Court: Who is going to say who composes the various groups?

Mr. Palmer: Some judicial body or personage will have to make that decision.

The Court: That's what I thought.

Mr. Palmer: Whether that would be this Court or some other Court, it will have to be a determination whether [fols. 3282-3295] it shall be the series groups—117 groups, considering state lines and series—or one entire group; but still, you must have two-thirds of that group, and our contention is that if in the State Court you get 50%, you can pay those off and go on with the rest of the group, but in this Court, you can't do that, and that is one of our bases of opposition to the debtor's petition.

The Court: I didn't mean to start an argument.

Mr. Palmer: I didn't mean to make a speech on our position.

Mr. Jaegerman: I want to say that I can't agree with Mr. Palmer's interpretation of the statute with reference to the plan.

Mr. Palmer: Why don't you say you prefer the Federal Court, and so state it?

The Court: I don't think it matters which one either one of you prefer.

[fol. 3296] Q. Can any life insurance company continue in existence that remains static and does not sell any policies?

Mr. Ray: I object to that, your Honor.

The Court: Overruled.

A. You mean by remaining static they do not sell any policies?

Mr. Palmer: Yes.

A. The company can't remain static and not sell policies.

Q. That's my question. If they don't sell policies.

A. If a company doesn't sell policies; they are under a [fols. 3297-3299] voluntary—they are naturally liquidating; they are not liquidating as far as assets are concerned, but liquidating as far as contracts are concerned, so far as volume of business is concerned. Theoretically a life insurance company is supposed to be able to liquidate; in one sense of the word, the figures are set up that they could liquidate down to the last person, but by that theory it is overlooked the fact that life insurance is made upon large numbers, and when a company is going down and liquidating and getting down to a few numbers, you have no average set, because you are referring to the specific case; therefore a mortality table means nothing when you are talking about a few individuals. It can only be applied to a large group.

Q. Therefore you must keep that large group to keep this law of averages working?

A. You must have a large enough number. The practical thing is that a company that does not get new business does not have new rates upon which they have policy holders which have been newly examined. If you take a specific group of policy holders that were examined years ago, the mortality may exceed 100%, while those that have been newly examined have been as low as eight to ten to twelve per cent.

[fol. 3300] Q. Now, can you tell me from your experience in the actuarial field if it isn't true that life insurance companies generally have lost money on annuities due, in part, to the fact that very healthy persons seem to desire the life annuities, and the mortality table has been very different from the mortality table for death under life insurance?

A. Well, as stated before, the result is exactly the opposite as life insurance. I might answer it this way. For years and years they have studied life insurance and established records in statistics on that, while life annuities have not been issued and a study has not been made for that for a sufficient period of time under the present conditions [fols. 3301-3303] in order for you to even know too much about it.

Q. And haven't you had to disassociate the mortality table for life insurance from the mortality table for annuity?

A. As a rule, a different table is used.

Q. And hasn't the annuity table been continually changing in the last few years—that is, the table used by the companies?

A. Companies—some companies keep changing the table they use, is how I might answer that.

Q. And isn't it true, or if you don't know, please so state—that because of the apparently erroneous calculations made by the companies, that they have—as it is called—lost money by virtue of the annuity table as contrasted with making a profit by virtue of the mortality table used in life insurance?

A. Well, it is the general consensus that money is being lost.

Q. By all of the insurance companies?

A. Not all of them—in general, I would say.

[fol. 3304] Q. With reference to Exhibits 111 and 112, can you tell us briefly what the difference is between the so-called uniform plan and the so-called graduate plan.

A. Well, as I testified before, I stated that those two exhibits were rough ideas of plans that may be used.

Q. I meant the difference in the terminology of the two words.

A. The graduated plan meant applying this percentage equity—in other words, a person's equity would be the

percentage determined by that fund alone, while the uniform plan was treating all funds alike; in other words, if one contract holder in one fund received 80% or 85%, the contract holder in another fund received 80% or 85%.

Q. And in the—

[fol. 3305] A. In other words, all contract holders of all funds were treated by the same percentage; they would receive the same percentage of their reserve.

Q. And in the graduated plan the A, B, and D contract holders would receive 90% of the special income, special annuity, and the remainder would receive thirty to fifty per cent?

A. It would vary according to each fund. I don't recall as to how each one varied.

Q. Now, you told us about these plans being worked out more or less cooperatively with a group—no one person working on any particular portion. Is that correct?

A. That's my understanding of it, yes.

Q. And you never devoted your entire time, or at tempted to, getting up some kind of a plan, did you?

A. No.

Q. And after the State Court receivers were in, you still had other duties whereby you couldn't devote your entire time to preparing a plan. Isn't that so?

A. That's right.

Q. Do you know whether or not a plan was ever arrived at by the group in which you worked or by any other [fol. 3306] group separately which could be put into effect?

A. There was none to my knowledge.

Q. Over how long a period were these various plans worked upon?

A. I couldn't answer that.

Q. (Continuing:) To your knowledge?

A. Some of them were in process when I became affiliated with Fidelity.

Q. Did each of the plans have in the background or as its basis the idea of Fidelity as a life insurance company?

A. While I was affiliated with Fidelity, I heard of no other plans than of it planning on becoming a life insurance company; in other words, all discussions with me were on the assumption that it would become a life insurance company.

Q. And all of your thoughts and suggestions and efforts which you would contribute to the group from time to

time were on that assumption or background. Is that correct?

A. That is correct.

Q. Did you ever attend any conference with the Securities and Exchange Commission or any of their commissioners in Washington?

A. I attended one conference there, April 1st 1941.

[fol. 3307] Q. In Washington?

A. In Washington.

Q. And at that time, was an attempt made to give the Securities and Exchange Commission some idea or rough plan—rough idea of a plan—which it was hoped might be able to be worked out?

A. As I recall, this Exhibit 11 and 12 that we were discussing a while ago was presented to the S. E. C. at that time, and there was considerable discussion on those plans.

Q. And Mr. Arthur Koontz was the one who was spokesman for your group in presenting those; he was there and made their original introduction?

A. He made the introduction, I would say.

Q. Who else was there?

A. Mr. Goldsmith, also of Koontz & Koontz, and F. S. Risley, the president, Mr. Frank McNulty and Mr. Pulfer and Mr. Clarke of Haskins & Sells, and Mr. Carver and Mr. Jaegerman and Mr. Jackson of the S. E. C.

Q. Was the discussion general with the idea of attempting to solve some way out of Fidelity's difficulties?

A. The understanding I had, the attempt was—they were attempting to agree more or less with the S. E. C. that [fol. 3308] some plan could be worked out whereby Fidelity may go through a voluntary reorganization. That was the whole entire intent and purpose of the meeting.

Q. What was the attitude of the S. E. C. or those who were there to speak on its behalf?

A. They didn't believe that the plans presented—Exhibits 11 and 12—as I recall, their chief objection was that the financial status had not been sound, based upon the status in those exhibits.

Q. Did they offer any suggestion of a plan?

A. The one point that I believe that they contributed was that the company should have some kind of "umbrella"—as they used the term—in other words, they must be protected by the Court to prevent a run on future cash liabilities.

Q. During the time of the conversion?

A. During the time of the voluntary reorganization.

Q. That was the suggestion to the S. E. C.?

A. Primarily, I think that was.

The Court: Wait just a minute. How were those two ideas reconciled—the two ideas of protecting the company by the Court, and at the same time, voluntary reorganization?

A. That was what I could never understand. If it was [fol. 3309] to be protected by the Court, I couldn't see that it was entirely voluntary, unless the company was voluntarily going into Court for a reorganization, rather than being pressed by some other outside creditors.

The Court: Are you speaking about Chapter 10?

A. Of course, no chapter was referred to. I don't know what else it could be. I stated that that was the suggestion offered. That might have been the point, it appeared to be to me, that they were most insistent upon, but as I understand it, it didn't seem voluntary to me.

Mr. Palmer:

Q. Mr. Sims and Mr. Justice were present?

A. I don't believe either were present.

Q. And isn't it true that Mr. Goldsmith and Mr. Koonitz, after the point was raised, discussed the possibility of putting an umbrella over the company by State Court proceedings?

A. I don't recall it being discussed with me.

Q. I mean, at the meeting—at the S. E. C. meeting?

A. Not to my knowledge.

Q. Did the S. E. C. state whether the umbrella should be in Federal or State Court proceedings, or did they state any court?

[fol. 3310] A. I don't recall any specific manner to be used; that is the reason I used the term as they did—an umbrella—because they generalized it as a method of protection.

Q. They just suggested that the legal processes of the Court be used to protect the assets of the company from a run on it during the process of attempting to evolve some sort of a voluntary rehabilitation?

A. The point wasn't covered too far; I wouldn't want to make the interpretation.

Q. Would my statement be a fair general statement, or would it be too specific?

A. I think that is the general idea. It was to prevent a run for the cash liabilities, as I understood it.

Q. During the period during which the company was to attempt to voluntarily rehabilitate itself into a going life insurance concern?

A. That is correct.

Q. And that was the apparent hope of each and all of those at that conference that that could be done?

A. Will you read the question?

Q. I withdraw that question and state it this way: It was the apparent hope of everyone present that Fidelity could [fol. 3311] be rehabilitated into a going life insurance concern?

A. That appeared to be the hope of everyone, yes, sir.

Q. That was apparently why they were there, to see if it couldn't be worked out?

A. That is correct.

Q. Did the S. E. C. or the gentlemen there at that conference have any specific ideas as to any plan which could be worked out?

A. I think they made themselves clear that that wasn't their objective.

Q. I see.

A. (Continuing:) That they were sitting in on a conference or hearing and listening to what we had to submit; it wasn't their job.

Q. Their purpose was not necessarily criticism, but raising proper objections to any plans that you would have presented to them, and not their purpose or design to build a plan for you and work on it. Is that right?

A. Well, I don't know in a sufficient amount of what preceded our going there; to answer their purpose—I can't answer for them.

Q. Did you ever see any rough draft or purported plans [fols. 3312-3319] of any kind supposedly prepared by the S. E. C. or anyone connected therewith for the help and aid of Fidelity?

A. I did.

[fol. 3320] RAYMOND LATTA, the witness who was testifying at the time of adjournment, resumed the witness stand and continued his testimony as follows:

Direct examination (continued).

By Mr. Palmer:

Q. Mr. Latta, how did you happen to go with Fidelity? What person or persons in Fidelity was responsible for that, if you know?

A. That I don't know.

Q. You were offered the employment and accepted it?

A. That is correct.

Q. We were speaking last evening when we closed about the April 1st meeting in Washington with the S.E.C. Would you again state, to refresh my recollection, all of those who were present at that meeting?

Mr. Ray: Your Honor, that is in the record.

[fol. 3321] Mr. Palmer: I said to refresh my recollection.

The Court: I think I will let him state it, because I suppose Mr. Palmer didn't take down the notes.

A. Those representing the S.E.C. were Mr. Jaegerman, Mr. Jackson, Mr. Carver. There was Mr. Koontz and Mr. Goldsmith of Koontz and Koontz.

Mr. Palmer: A little bit louder.

A. Mr. Koontz and Mr. Goldsmith, Mr. Risley, Mr. McNulty, Mr. Pulfer, and Mr. Clarke of Haskins & Sells and myself.

Mr. Palmer:

Q. There was taken over there and presented to the S.E.C., was there not, some form of tentative or rough plan for voluntary rehabilitation of Fidelity?

A. That is correct.

Q. That plan was in typewritten form, is that correct?

A. That is correct.

Q. When was that plan put into typewritten form, if you know?

A. Well, just prior to going over to the meeting.

Q. Just prior to going into the meeting or over to the meeting.

A. Just prior to leaving Wheeling for Washington.

Q. That plan, as I understand it, was more or less the [fol. 3322] joint or cooperative work of a number of officers and employees of Fidelity, is that correct?

A. Yes.

Q. Who all took part to any appreciable extent in helping formulate the ideas or various parts of the plan?

A. Well, I can't state that definitely. Some of those ideas had been prepared prior to my going with Fidelity.

Q. Well, after you got there, did Mr. Risley partake of part of the work?

A. Various parts of it we advised and used in a plan where Mr. Risley and Mr. McNulty and, as I recall, Mr. Messick and Mr. Pulfer all contributed various ideas. Beyond that I don't know what individuals were involved. There were others.

Q. Together with yourself to some extent?

A. Yes, I collaborated.

Q. To your knowledge, how far had that plan that was presented that day been discussed with Mr. Arthur Koontz before it was presented?

A. You mean the one that was presented in typewritten form?

Q. Yes.

A. Well, it was only completed just before we left for [fol. 3323] Washington and about in—I don't know what was discussed with him.

Q. So far as you know, he had not seen the plan prior to its presentation?

A. Well, so far as I know. I had not had an opportunity to see the plan myself.

Q. It is your understanding, is it not, that Mr. Arthur Koontz had arranged this conference and that the officers and those who had worked on the plan were to be present to present it to the S. E. C.?

A. I don't know how the arrangements were made.

Q. That plan provided for a voluntary acceptance by the contract holders, is that right?

A. That is right.

Q. And did it also provide that those who didn't want to accept it wouldn't have to?

A. That is correct.

Q. Now, tell the Court this. Those who did not accept the plan, would they be the same or better off or worse off than those who did accept the plan?

The Court: How would he know?

Mr. Palmer: From the plan, your Honor.

[fol. 3324] A. Well, the plan provided that those who accepted—those that voluntarily accepted the plan would take a loss, which would be used to cover deficiencies. Those who did not accept the plan, their contract would continue as it is.

Q. So that one of the major difficulties with this voluntary plan was that those who did not accept it would be—if the plan were accepted by the others—better off than those who did accept the plan voluntarily? Is that in effect correct?

A. Well, one takes a loss and the other doesn't.

Q. Will you explain that by example to the Court? For instance, suppose there were a three-million-dollar deficit and a thousand contract holders, five hundred of whom accepted the plan and five hundred of whom did not. Will you give the Court—use that or some similar example a concrete basis to show how those who accepted would be worse off than those who did not accept it?

A. Well, as I recall, the plan it provided for—that is, the uniform plan provided for, assuming a 15 per cent decrease in their equity. Therefore if a person had a hundred-dollar equity, if he accepted the plan he only received [fol. 3325] eighty-five dollars, while if he didn't accept it, his equity still remained a hundred dollars.

Q. When you use equity in that sense, will you give your definition of the word "equity"?

A. Well, that is the amount he has coming from the assets that are held by the company at any given time.

The Court:

Q. You mean according to his contract; not according to the amount available to pay him?

A. That is right. His claim.

Q. So what you call his equity may be something different from what his actual equity was?

A. Well, no. As a rule I don't call equity that. I call equity the amount he has coming in proportion to the claim.

His contract called for a claim of a hundred dollars, but the plan provided that if a sufficient number would reduce their claim from a hundred dollars to eighty-five dollars, the company became solvent then. Of course, their equity would be to the extent of their claim.

Q. What I am driving at is this: If this company was insolvent to the extent of, say, fifteen per cent and everybody had an equal priority with reference to his claim, then the equity would actually be worth only eighty-five per cent of the amount of the claim?

[fol. 3326] A. That is correct.

Q. So when you say they would take a reduction in their equities, you don't mean that strictly, do you?

A. After the plan was completed, if a sufficient number covered the deficiency, then the equity in both cases would be a hundred per cent of their claim. In one case their claim would be eighty-five dollars, while in the other instance it would be a hundred dollars and their equity would be reduced accordingly. Their equity as termed in percentage, however, would always remain the same in proportion to the claim. If he reduced his claim, then his equity is reduced in proportion.

Q. Well, now, if the company is actually ten per cent insolvent and two-thirds or approximately that of the total number of contract holders were willing to take a cut of fifteen per cent in order to pay the other one-third, then that would conform roughly to the outline of the plan?

A. That is correct.

The Court: All right.

Mr. Palmer:

Q. What did Mr. Pulfer have to say as to whether that plan could be put into practical effect, and by what means of contacting the contract holders?

[fol. 3327] Mr. Ray: Your Honor, that would be hearsay. Mr. Pulfer has been here.

The Court: I don't see the materiality of that. If you will explain it—

Mr. Palmer: If your Honor please, we want to show admissions of the Debtor—I mean admissions against interest—and we want to show particularly what was attempted to be done by the Debtor and how it was attempted to be done.

In other words, I understand Mr. Pulfer, being a man of wide selling experience, was speaking for the group in explaining to the S.E.C. how you could get this plan over to the contract holders and get their consent and I wanted the witness to go into that phase of it.

The Court: But you didn't ask Mr. Pulfer anything about that. He was on the stand for examination——

Mr. Palmer: Mr. Pulfer forgot to tell us that he was in Washington, your Honor, and I didn't know it.

The Court: If he wasn't asked, I don't know that he had any obligation to tell you that.

Mr. Palmer: The Debtor didn't bring that out. The Debtor was the one that knew he was there; I didn't know it.

Mr. Huwe: Your Honor, this uniform plan calling for [fol. 3328] eighty-five per cent was the combined work of a number of people. It was in existence prior to the receivership and had been in the possession, I presume, of Mr. Palmer for a long time and one of the strongest parts of it is:

"It is proposed to secure the exchanges by both personal solicitation and mail. The selection of the method to be used will depend largely upon the residence of the contract holder."

That probably is Mr. Pulfer's contribution to this plan. This was in Mr. Palmer's control. While Mr. Pulfer was on the stand he could have asked him about it then. Even though he didn't know Mr. Pulfer was in Washington, he did know Mr. Pulfer contributed to the plan.

Mr. Palmer: I beg your pardon. I did not know it.

The Court: Sustained.

Mr. Palmer: I would like to make a proffer that at this meeting at which there was a general conversation with the S.E.C. Mr. Pulfer advised the S.E.C. that within sixty to ninety days he could get in touch with a sufficient number of contract holders, that the plan would be accepted, and that he could do this by direct mail first and by personal contact later so that the plan was a practical feasibility to be put in operation at that time; and that the Securities [fol. 3329] and Exchange Commission thereupon raised the objection that it could not be done within the time limit set.

Now, if your Honor please, I offer this not as what Mr. Pulfer said, but as part of the general conversation about

this particular plan by the officers of Fidelity in their meeting with the S.E.C. in Washington. It is nothing against Mr. Pulfer or in any way detrimental to Mr. Pulfer. It was merely what the company was attempting to do at that time; and we want to show the various steps the company has taken in attempting to pull itself out of the difficulty before state receivership proceedings were brought; and I think what anyone contributed to that desire to help themselves should be relevant to this issue here.

The Court: I can't see how what Mr. Pulfer said in that conference would be relevant, because if it were, every single thing that was said in the conference would be and also every single thing that was said in every other conference that was held with reference to rehabilitating the company, and I am confident that that is not so and I sustain the objection.

[fol. 3330] Mr. Palmer:

Q. What if any other objections did the Securities and Exchange Commission raise to the plan other than those that you and I have already discussed, Mr. Latta?

A. I don't know what objections—any other objections particularly raised to the plan.

Q. Did they raise any objection as to the fact that the contract holders who did not accept would be better off than those who did?

A. I don't recall any specific objections there, no.

Q. Did they raise a point as to whether it could be put into practical effect by getting in touch with the contract holders as the plan suggests in the way Mr. Huwe read?

A. I think they covered that point particularly.

Q. Did the Securities and Exchange Commission approve the plan?

A. No, I can't say they approved it, no.

Q. After that meeting in Washington, was there a further meeting in Charleston? If so, who attended it?

Mr. Ray: Your Honor, isn't he going all over the same ground?

Mr. Palmer: Same ground as what?

Mr. Ray: That you went over yesterday.

[fol. 3331] Mr. Palmer: I am sorry. I don't think so.

Mr. Ray: You asked about meetings in Washington yesterday and about meetings in Charleston yesterday.

The Court: I don't remember his asking about a meeting except for Washington. Overruled.

A. I don't know of any meeting, no.

Mr. Palmer: I beg your pardon?

A. I don't know of any meeting.

Q. Well, did you and others meet in Charleston?

A. We left Washington and came to Charleston.

Q. Did you have a conference about Fidelity?

A. Yes, we had conferences. Naturally, we were in conference most of the time while I was there.

Q. During the course of those conferences in Charleston after that meeting in Washington, tell the Court whether or not you were given any information as to any proceedings being brought?

A. The day after the meeting we left Washington and came to Charleston. One of the first things I heard the following morning was that proceedings were going to be taken by the—by the Auditor, Mr. Sims.

Q. That was court proceedings?

A. Well, I didn't know what the proceedings were. He [fol. 3332] was going to take steps to take the company; I presumed it was court proceedings.

The Court: He had notified the company of that before you ever went to Washington, though, hadn't he?

A. I heard rumors of it. I didn't know.

Q. This you heard after you came back from Washington was just a continuation of the rumor you heard before you went, wasn't it?

A. Well, yes, you might say it was revived. I know before we left to go to Washington a rumor came out that Mr. Sims was going to take steps. As to what those steps were to be, I didn't know, and then I heard that he was going to wait there till we went to Washington to see how the meeting turned out and since nothing conclusive was reached at the meeting, my understanding was that he was going to definitely take steps and he was not going to wait any longer.

Mr. Palmer:

Q.*Reverting for a minute to the Washington meeting, was there brought up or discussed or did you know of any

possible idea of attempting to have Mr. Sims declare a moratorium on cash surrenders of the company?

A. Well, the S.E.C. did—it was their strongest opinion [fol. 3333] and they tried to get the admission from the company, it appeared to me, that the company was insolvent; they should stop paying cash surrender values. That was one of their great objections to going into the plan. In other words, it wasn't on the plan particularly, but they did object to continuing paying out cash surrender values when we were trying to go through with voluntary reorganization and have certain contract holders take a loss which would be more or less admitting the deficiency, and why pay out a hundred cents on the dollar to those who came in and asked for their cash today? That, in general, I think, covered the point.

Q. What, if anything, was suggested about the moratorium to be declared by Mr. Sims?

The Court: Mr. Palmer, I don't understand your term "moratorium" or how Mr. Sims could declare any moratorium.

Mr. Palmer: I don't either, your Honor. That is why I am asking the witness about it.

The Court: All right.

A. Well, there was some discussion as to whether they could declare a moratorium on the cash values for a period of time while this plan was being carried out—

The Court: Who could declare it?

[fol. 3334] A. That I couldn't learn. It was mentioned as to whether Mr. Sims could declare a moratorium without going into court—a temporary moratorium for a period of time. As to whether he could or not, I couldn't find out from anyone and no one seemed to state definitely what the steps would be or how. I didn't understand it myself.

Mr. Palmer:

Q. If a moratorium had been declared which lasted more than sixty days, would that be in violation of the terms of the contract?

A. Well, the contract, in my opinion, provides that the company must pay the cash value within sixty days from the application, or something to that effect.

The Court: It wouldn't be necessary, then, to have a moratorium during that sixty days?

A. No, but that goes back to the question as to how long it would take. In other words, the S.E.C. felt that no cash value should be paid. Then the argument arose as to whether the plan could be put into effect within sixty days.

Mr. Palmer:

Q. And was there a discussion had about whether it could be put into effect within sixty days?

A. There was various discussions pro and con.

[fol. 3335] The Court: With reference to this so-called moratorium, now, that wouldn't begin to be effective until the sixty-day period was up?

A. That is true because we were allowed sixty days in the contract at our option.

Mr. Palmer: And what, if anything, was said as to whether it would be an act of bankruptcy if at the end of sixty days anyone declared a moratorium and the company did not meet its obligations as set out in its contract?

A. There was some discussion in that regard as to whether it would be an act of bankruptcy or not, but I don't believe any conclusion was reached that I heard except there was a discussion as to whether that would be an act of bankruptcy.

Q. Was there a discussion as to whether or not within sixty days the company could put over its plan to the contract holders?

A. Yes, there was some discussion on that.

Mr. Palmer: Now, if your Honor please, it is in reference to that discussion that Mr. Pulfer took part in that I want to ask about that discussion. I didn't want to go back into it over the Court's ruling.

The Court: I permitted you to develop that there was [fol. 3336] a discussion but I will have to sustain an objection to any questions as to what the discussion was.

Mr. Palmer: All right, sir.

Q. Now, getting back again to the conferences in Charleston, did Mr. Tom Foulk come from Wheeling at any time to take part in those conferences?

A. I believe he was here on Saturday—Friday or Saturday following—well, he was here in Charleston the last day that we were all here.

Q. That would be the third or fourth of April or fifth?

A. I would say the fourth; approximately.

Q. Mr. Pulfer said something about your having a plan—he didn't say whether it was oral or written—which you gave the rough details of at that meeting. Would you tell us first whether it was an oral or written plan?

A. The only thing we had was a verbal discussion on a plan of reorganization by voluntary basis different from that which was presented in Washington.

Q. You say different from that?

A. Yes, but they were both voluntary is the reason I said that.

[fol. 3337] Q. Will you give us what your ideas were as you expressed them to the others?

A. Well, when they heard of the proceedings being taken or that they were about to be taken, they were trying to find out if it was some voluntary plan that could be used that may be practical to be put into effect in a short period of time; and the thought was in presenting some plan of that nature to the Commissioner or to the Auditor to see if he wouldn't hold off the proceedings against the company. Now, the plan that was presented in Washington provided a complete change of the contract, in addition to the contract holders agreeing to take a loss, and it didn't—the consensus of opinion of a number of individuals was that a plan of that nature could not be put into effect in the short period of time; so they were trying to find some working mechanics that might be; so the plan discussed mostly was a voluntary lien plan which would require no change in the present contract immediately, but those accepting the plan would agree to a voluntary lien placed against the contract. By a lien I mean the company's claim against the reserve on that contract, which, after putting into effect, would become and be treated in the same manner as any [fol. 3338] policy or any contract loan in use by the company.

Q. In other words, this lien is a little different from what we lawyers speak of as a lien. It is just the same as though the policyholder borrowed the amount of the lien, but the company doesn't give him any money, but calls it a policy loan and treats it as such except that the lien covers the

deficit by agreement of the policyholder instead of him getting money for his loan. Is that, in layman's language, about what it means?

A. Approximately. The lien is assumed to cover the deficiency and would bear interest in the same way as a contract loan and would be a claim against the contract.

Q. And it is an agreement voluntarily made by the contract holder to make up the deficit in his particular fund?

A. That is correct.

Mr. Jaegerman: That would bear interest to the contract holder, wouldn't it? The contract holder wouldn't have to pay interest to the company, would he?

A. The lien would increase as the result of the interest.

Q. But the contract holder wouldn't pay that interest? [fol 3339] A. He wouldn't have to pay it in cash. It would be exactly the same as a contract loan except that it was intended that it should bear a different rate of interest, a rate of interest comparable to that on the reserve. If a person had a hundred dollars reserve and he was assuming a thirty per cent lien, actually he is reducing his equity to seventy dollars. However, since his contract has not been changed, his reserve remains at a hundred dollars. Therefore, he is charged interest on the thirty dollars that would offset interest that he is paying on the hundred while his equity is only seventy, and the effect is that he actually has an equity of only seventy dollars, while his contract calls for a hundred, but to keep from changing the contract, it continues to be a hundred. The interest charge on the loan is just offset on the over-statement of his lien over his equity.

Mr. Palmer:

Q. What was decided, Mr. Latta, at that conference as to whether that oral suggestion or idea of a plan could be put into prompt effect?

A. I don't know that there were any particular decisions except it was just felt—seemed to be the consensus of opinion that it could be put into effect much more readily [fol 3340] than any plan previously discussed, although any decisions—I don't know of any decisions that were reached.

Mr. T. C. Townsend: It would take the consent of the contract holder to put it into effect, wouldn't it?

A. Yes. In other words, no contract holder had assumed a lien until he consented. It was a voluntary plan.

Mr. Palmer: And was it again the proposition that those who did not consent would be better off than those who did not consent?

Mr. Townsend: I object to that.

The Court: You say, "Was there again the proposition."

Mr. Palmer: No, the flaw.

Mr. Townsend: Read the question.

(The question was read.)

Mr. Palmer: I will say "flaw" instead of "proposition."

Mr. Ray: What right does he have to say it was a flaw?

Mr. Palmer: Were those who did not accept this plan to be offered to them better off than those who did accept it?

[fol. 3341] The Court: It is a legal conclusion, it seems to me.

Mr. Palmer: No, your Honor, it is a practical matter as the witness explained to the Court before; not a legal conclusion, but a mathematical calculation in the field where this man is an actuary.

The Court: Well, it certainly seems to the Court that if there were no corresponding changes in the plans for the ones who did accept it, and you say to one man, "We will give you a hundred per cent," and to another, "We will give you eighty-five per cent," that it is just obvious, without the need of any question, that the man who gets the hundred per cent gets more than the man who gets eighty-five per cent. I understand, however, that when the witness speaks of a plan, he means some sort of arrangement whereby the person that took the cut would get some corresponding advantage.

Mr. Palmer: That is what I was going to ask him, whether they would or would not.

Can you answer the Court's question, Mr. Latta, whether or not those who took the cut would get an advantage which those who did not take the cut would not get?

A. No, he wouldn't have any advantage the others [fol. 3342] wouldn't get.

Mr. T. C. Townsend: He would have a disadvantage, wouldn't he?

A. Well, the only difference between the two, one has taken a loss and the other has not. Outside of that, their contracts remain the same.

The Court: Mr. Latta, what is the difference between this plan you have talked about and the situation where there is a thousand dollars to be divided and fifteen hundred dollars of claims against it, and you go out and say to creditors that have the claims, "If you will all take a reduction amounting to two hundred dollars, we can distribute the thousand dollars, but if certain of you want to take a deduction and others don't, we will pay the ones that don't a hundred per cent and the others that do will get correspondingly less." Of course, such a plan as that would not appeal to anybody. I want to know, what is the difference between that sort of a plan and the plan you are talking about.

A. That is roughly the principle of the plan.

Q. Well, then, what hope did you have that anybody would ever sign it?

[fol. 3343] A. Well, the only hope that a voluntary plan might be put into effect is that a sufficient number of people representing large enough claims would contribute enough to cover the deficiency in order to keep the company going.

Q. What benefit is it to them to keep the company going?

A. Those people, probably the only reason they would agree to it, thinking that even after taking that cut they would be better off than if the company went into Court and was liquidated or some other proceedings taken.

Q. Is there any basis for that?

A. In this company I don't think there is the basis there is in an insurance company. In an insurance company there is definitely a basis for it.

Q. Was there a basis in the situation here?

A. Yes, there was some in the case of approximately half the contract holders, half the contract holders having insurance-protected contracts. Out of those, a number of them could not—although they were eligible for insurance at the time these contracts were issued, but at the present time they may be uninsurable. They had insurance protection which might have been carried on.

[fol. 3344] Q. Wasn't there also an advantage to the ones who signed such a plan that their contracts would be continued and that the rate of cash values in those contracts would increase in the future at a higher percentage than it had increased in the past, so that they would then get the benefit if their contracts were carried to conclusion of some large deductions that had been made from payments in the beginning with corresponding smaller deductions made towards the end of the payment of the contract? Wasn't there that advantage?

A. No, I don't think there was any difference in the deduction to be made or any deduction in the interest that they would receive.

Q. I don't mean to say that the contracts would be changed in that respect, but it has been developed that in the case of these contracts, their cash values during their earlier years are comparatively small and that during their later years, their cash values increase much more rapidly than they do in the early years. Doesn't that furnish some incentive to a contract holder to want his contract to go ahead to completion rather than take the cash value now?

[fol. 3345] A. Why, yes, because if they quit now and still want to continue making payments on the contract—or some new contract—they could not at the present time go out and buy a contract that would pay them as high an interest payment. Then in addition to that, when you buy a new contract, you have a certain amount of loading that must be paid in the earlier part of the contract, that is, presumably, the first year. After approximately the first year, I can't say that there would be any difference in the amount of increase in proportion to the payment made.

Q. Wasn't it that element in the situation that was counted on to persuade these contract holders to sign up to take their loss?

A. I think that is true in any reorganization. That is one of the purposes of reorganization.

Q. That was the offset the man got who had to take his loss of fifteen per cent?

A. Yes, sir.

Q. He got that offset to recompense him for the amount of cash, not getting a hundred cents on the dollar?

A. That is correct.

Mr. Palmer:

Q. Mr. Latta, I am not certain, in view of the Court's [fol. 3346] last statement that the Court fully understands the entire proposition. The man who doesn't accept the plan didn't cash in; he went right along and paid, but he had a contract that called for a hundred cents on the dollar. Isn't that right?

A. Why, yes, they would both be able to continue their contract. One takes a loss and the other doesn't. That is the only difference between the two contract holders. But, I understood the Court's question more or less to be the advantage of—or why a person would agree to accept a loss.

Q. Persons who had only been carrying the policies for a few years would have a distinct advantage in taking the loss and going ahead as the Court has suggested so that they could in time have their cash surrender value equal the amount paid in, whereas perhaps a person who had been carrying his contract for seven or eight years wouldn't have that same impelling motive on that. That was the Court's suggestion. Do you agree with that?

A. I think that is true.

Q. So that there were some advantages to be gained by those who would accept the voluntary reduction as compared with those who did not?

[fol. 3347] A. I don't think that comparison can be made.

Q. You don't think that comparison can be made. Both were, however, under the plan expected to go on and continue their payments and maturing their contracts?

The Witness: Will you state that again or have it read?

(The question was read.)

A. There was no difference in the two whether one accepted or the other did not, except that the lien assumed by a certain number would be used to cover the deficiency. That is the only difference between the two that I can see.

Q. In your experience have you known of life insurance companies where a similar proposition to this was offered where anyone who desired could take a voluntary reduction or have a lien placed against their policy and those who didn't want to didn't do it and whether that company went on and then was able to operate after that was done—one or more companies that did that, and mention their names, please?

A. Well there are two companies that I know of that used a voluntary lien plan very similar in nature. One of them was continued and is in business today. The other put the [fol. 3348] voluntary lien plans into effect and then was later reinsured with a company assuming the contracts with the liens against them.

The Court:

Q. Mr. Latta, do you think it is possible to get as equitable a result by that sort of plan which you call the voluntary lien plan in case two-thirds of the contract holders in certain classes want to do it and the other third don't want to do it—do you think it is possible to get as equitable a result in that way as it is by some plan where the other third is forced to comply with the wishes of the two-thirds?

A. Are you referring to the voluntary lien plan?

Q. Yes. I am asking you whether you think that voluntary lien plan produces as equitable result in cases where there are as much as two-thirds of the creditors or contract holders of a certain class that want to put it into effect as a plan, whereby the other third would be forced to comply and take its proportionate share of the loss, too?

A. I will answer that in this way: The voluntary lien plan, as far as my understanding of it being equitable, there is nothing equitable about a voluntary plan.

[fols. 3349-3363] The Court: That is what I thought.

The Witness: Because when a person accepts a voluntary lien plan, that is just an agreement between that individual and the company, while another case it is based on equal dollars and cents.

[fol. 3364] The Court: I will sustain that objection in that form. I will ask the witness this question, however, which I think will cover the situation, as I see it.

Q. Mr. Latta, is it possible to construct an actuarial plan of reorganization for Fidelity?

A. Yes.

Mr. Palmer:

Q. In your experience, Mr. Latta, would that actuarial plan work?

Mr. Ray: Oh, that is the same thing in another way, trying to get the witness to answer something the Court has ruled he is not qualified to answer.

The Court: Sustained.

Mr. Palmer: I will have to make an offer upon the record, your Honor.

[fol. 3365] The Court: All right.

Mr. Palmer: The witness, if permitted to answer the question, would state that it is unreasonable to expect a plan of reorganization can be effected for Fidelity. The witness would further say, if permitted by the Court so to testify, that Fidelity itself can never be reorganized as a going concern, either as a face amount certificate company or as a life insurance company. If the Court would permit, I would like the witness to be permitted to state his reasons why Fidelity can never be reorganized and operated as a face amount certificate company and as a life insurance company, those reasons being based upon his experience and actuarial knowledge. I ask the Court's permission for that.

Mr. Huwe: Your Honor, I move that the proffer be stricken from the record for the simple reason that all of Mr. Palmer's statement precludes any company other than a face amount certificate company or an insurance company, and there are possibilities beyond those two categories in which the Debtor could be reorganized, and therefore any statements in any proffers limited to those two fields are not proper.

Mr. Palmer: Will you inform me the other possibilities, [fol. 3366] please?

The Court: There is no use to argue that. All Mr. Palmer has done is to say on the record that he believes this witness would make certain answers if he asked him certain questions. Those answers may be that the earth is flat when as a matter of fact we know it is round, but if that has bearing on the case, and this witness's answer might have some arguable basis for being received, I feel that I would have to permit that to go on the record; so, regardless of what the facts may be, I am going to permit Mr. Palmer to make his proffer.

Now, he asked to be permitted to ask the witness a question, and as I ruled before, I will permit any questions to be addressed to this witness's knowledge of actuarial

figures and plans, and if you will form your question, I will determine it.

Mr. Palmer:

Q. Mr. Latta, can you give, from your actuarial experience, reasons why Fidelity can never be rehabilitated itself into a going life insurance company?

Mr. Ray: Your Honor, that is putting into the record just exactly what you have excluded—an opinion of this witness.

The Court: He said a while ago in answer to a question [fol. 3367] that I directed to him that it was possible to prepare a plan of reorganization for Fidelity from an actuarial viewpoint, having stated that any opinion as to whether or not this plan would work would involve qualifications which he has said he does not possess, and so I will sustain the objection to the question.

Mr. Farmer: If the Court please, I would just like to call the Court's attention to this: That this witness who is now being asked these questions is a man who is brought here by Fidelity and entered its employ about the first of this year for that very purpose, as I understand it, of trying to assist in working out a plan, and he remained in the employ of Fidelity until it went into receivership; he remained in the employ of the receivers and remained in the employ of the Trustee until September 15th of this year; and if there is anyone who, from experience and study, especially the study of this company, and his board training that he has had elsewhere and experience in other reorganizations, who is qualified to assist the Court in this way, it seems to me that this is the man.

The Court: You attorneys are undertaking to establish this witness's qualification simply by the statements that you are making to the Court. It happens that the answers [fol. 3368] that he has made have shown that his knowledge is confined to mathematical figures and until that is changed in some way by the witness's statements, I cannot go any further.

Mr. Palmer:

Q. Mr. Latta, is your knowledge of Fidelity and the possibilities of its rehabilitation confined wholly to mathematical figures?

Mr. Ray: He testified about that fully yesterday.
The Court: Let's see what he says now.

A. That depends largely on what you mean by mathematical figures. I don't know that any two people can have the same opinion exactly of what it means by mathematical figures: Figures mean nothing except an expression. It is a means of computing and determining the quality of two expressions. In making a contract, we don't do it by just formulas, exactly. I still stick to my statement yesterday as to the actuarial phase of it; I am not trying to change that, nor do I care as to whether I answer the questions asked.

Mr. Palmer:

Q. The actuarial field includes more than mere figures addition and subtraction?

A. The subject of actuarial mathematics covers all phases of operating a life insurance company.

The Court: You mean covers selling—
[fol. 3369] The Witness: I was going to add that, with the exception of actual selling in the field.

Mr. Palmer:

Q. With the exception of selling in the field, it covers all phases of what—?

A. All phases of operating a life insurance company—and the making of investments, naturally it wouldn't—the interpretation of effects and results of selling or the results of the investments comes under the actuarial phase of it.

The Court: That gets us to this point in this witness's testimony. He says an actuarial plan can be developed for the reorganization of Fidelity. He says he knows nothing about the selling. When we put those two answers side by side, it strikes me that the witness can't be permitted to go ahead now and say that he has certain opinions about the success or failure when he has already said that a plan can be developed and he knows nothing about the selling end of it.

Mr. Palmer: If your Honor please, I am afraid the Court is not quite quoting the witness exactly. He said he knows nothing about selling in the field but he did know

the effects of selling. -That is, he knows the effects from an operating viewpoint of selling, but does not go into [fol. 3370] the field and sell.

The Court: I don't know what he means when he says he knows the effects of selling.

Mr. Palmer:

Q. Will you tell the Court what you mean by that, Mr. Latta?

A. By selling in the field, I mean supervision of their agents and their sales talk. However, the appeal of the contract and the contents of the contract must be worked out as much by the actuary as it is by the sales manager or someone connected with the sales, because the sales manager knows nothing about the operations of the contract and whether it is profitable, sound, or otherwise, any more than the actuary knows about the selling. Now, in the reorganization plan, I know that in past cases where we have been called in that naturally we have been—worked on—the first thing we do, as a rule, is make a survey to see the possibility of making out a complete plan of reorganization which covers all phases of it except the manner in which to contact the contract holders. I don't know that you can define the discrimination where one cuts off and the other starts. I have never been able to do it in the past. I surely can't explain where one cuts off and the other starts.

[fol. 3371] Q. With reference to Fidelity, have you conferred with Mr. Pulfer, one of the selling heads, concerning the salability of Fidelity in any rehabilitated form?

Mr. Ray: I am going to object to that, your Honor, because he has already testified as to his familiarity with the selling phases.

The Court: Mr. Pulfer has been a witness in this case and as I recall, he said that in his opinion reorganization could be effected and the contracts sold to the public. I am not certain that he said it unqualifiedly, but if so, and this witness has conferred with him, then we would have to say that he got that information from Mr. Pulfer. Then if he would answer contrary to that information, certainly his conference with Mr. Pulfer couldn't have anything to do with his opinion. I will sustain the objection.

Mr. Palmer: I will make an offer into the record that the witness did confer with Mr. Pulfer, one of the selling persons of Fidelity, and as a result of such, he became familiar with the selling end of Fidelity, both as a going concern and with reference to possibility of rehabilitation thereof.

Mr. Ray: Show an objection to counsel vouching the record as to what he believes the witness would say in [fol. 3372] answer to questions when the material put in the record flatly contradicts what the witness has heretofore said on direct examination.

The Court: Overruled as to the last objection.

Mr. Palmer: I ask that the remarks of counsel in that regard be stricken from the record.

The Court: No, I think there is some basis for that.

Mr. Palmer:

Q. Mr. Latta, will you please explain your answer to the Court's question when he asked you if Fidelity could be reorganized actuarially—I don't know the exact question, but you answered the Court's question "Yes." Would you explain your answer, please?

A. Actuarially whether it could be reorganized strictly from a mathematical viewpoint, as I interpreted his question to be, would be as to whether there could be computed, as far as figures are concerned, in order to place this company in a solvent condition, ready for operation on a sound financial basis as of that time. That is my interpretation of what he meant.

Q. Would it be possible to answer the Court's question by saying, "We will take from each contract holder forty per cent or place a forty-per cent lien upon each contract holder," work that out actuarially, and then you would [fols. 3373-3376] have the company reconstructed actuarially upon a sound basis? Would that be possible?

Mr. Huwe: I object to that question.

The Court: Overruled.

A. It would make the company solvent, but it wouldn't be reorganized on a sound basis, no.

Mr. Palmer: Beg your pardon?

A. It would be solvent at the time provided the forty per cent was sufficient. You could make the company sol-

vent, but that doesn't make it sound from an operating viewpoint, actuarially or otherwise.

Q. What would you do to do that?

A. Well, as far as a plan of reorganization was concerned, you would have to make the entire construction of the company so that the future operations could be done on a sound basis—could be carried on on a sound basis. By a sound basis, I mean as far as being able to meet the obligations when they may become due as specified in the contract.

[fol. 3377] Mr. Palmer:

Q. In other words, whether or not you could possibly construct an actuarial plan for Fidelity and your answer to that bears no relation to what your answer would be as to whether Fidelity could be successfully rehabilitated, is that correct?

A. They are entirely separate questions.

Q. And bear no relation to each other?

A. No.

Mr. Palmer: Then we will, if the Court will pardon us, ask that the Court's question and answer be stricken.

The Court: No, that is the phase of it that this witness has qualified himself to speak on. I have permitted you to develop that that phase has nothing to do with whether the company could successfully operate. I never thought in the beginning that it had anything to do with that, but nevertheless it is the phase that this witness is familiar with and the one on which his help to the Court may be of some value.

Mr. Palmer: If your Honor please, I think I see our difficulty. The Court has assumed that an actuary of actuarial [fol. 3378] experience is one who deals only with building up a mortality or actuarial table, whereas I think the true situation is the actuary is one who is familiar with every detail of the life insurance business. In other words, he is the general manager of the life insurance business, knowing every one of the branches of it.

The Court: This witness has not said that.

Mr. Palmer: I thought he did say it.

Mr. T. C. Townsend: You are thinking about Steussy.

Mr. Palmer: Mr. Latta, how far wrong am I in my state-

ment with reference to what an actuary is with reference to a life insurance company?

The Court: I don't like to give the witness that kind of question, how far wrong are you. I want him to tell me—

Mr. Palmer: Tell us, Mr. Latta, in detail as much as you can, what an actuary does and knows about the life insurance business.

The Court: What do you know about Fidelity is what I want to know.

Mr. Palmer: I would like to know about Fidelity and the life insurance business, your Honor. There isn't any such [fol. 3379] animal as I know it as an actuary of Fidelity, because Fidelity, if I may say so, is a monstrosity of which there are only one or two in existence and bear only a slight semblance of resemblance to other financial institutions. This gentleman comes qualified as a life insurance actuary. Whether or not his experience in that field will help in Fidelity we can investigate, but first I want to find out what is his experience in the life insurance field. That is his field and deep sea diving for Fidelity has been something of a side experience.

The Court: As to his qualifications, they are going to depend here on what he has been able to learn and know about Fidelity and not what he knows about life insurance actuarial practices in general.

Mr. Palmer: Can we first show what an actuary of a life insurance company does and knows to show this man's general background and qualifications?

The Court: Well, if he can make it any more definite than he already has. I thought he covered it.

The Witness: I think I answered that question a while ago that you can't draw a line where a phase of it cuts off and other phase of the business starts, and I also said—

[fol. 3380] Mr. Palmer: Does an actuary have anything to do with building up the life insurance policies—the terms of them—not the figures, but the conditions and terms?

A: As a rule, I believe most life insurance contracts are drawn by the actuaries in collaboration with an attorney for the legal phases and interpretation.

Q. What, if anything, does the actuary have to do with reference to discovering whether the policy he draws up is salable or not before he draws it up?

A. He has to work with the sales manager somewhat in the same manner that he worked with the attorney, as far as the actual drafting of the contract.

Q. Now, what does he have to do with reference to finding out the operating cost, whether the company could make money on selling that particular policy?

A. Well, that is for him—that is his job to determine. In life insurance work, the actuary is usually in the same category as a certified public—an accountant, I should say, would be with some other company. In other words, they deal with the operations, the causes and effects of the profits [fol. 3381-3391] and losses to be made as a result of changes in operation or whatever may be done—any phase of the operations.

Q. Does he have to know the various operating expenses, as well as operating income in order to be able to carry on his job properly?

A. Well, yes, that deals with the operations.

Q. And he has to realize how much income will come in from a policy and what the operations and overhead of the company will be — reference to it, is that correct?

A. That is correct.

[fol. 3392] The Court: If this witness is asked what it is necessary to do in order to convert Fidelity into a going life insurance company, I will permit him to answer that question and then we will leave it for the Court to decide or for some qualified person to give his opinion as to whether or not on the doing of those things a successful plan of reorganization would have been effected.

Mr. Palmer: All right. Can you give us your answer, [fol. 3393] Mr. Latta, to the Court's suggestion?

The Witness: May I have the Court's question read?

The Court: I didn't ask him a question.

Mr. Palmer: I meant, give us your ideas as to the Court's suggestion what you would be permitted to testify.

Mr. Ray: Your Honor, I think that is practically the question which Mr. Palmer asked immediately upon resumption of the hearing and the witness said he couldn't do it; that there would be infinite—

The Court: You may be right about that, but if he can do it, I am willing to permit him to do it.

Mr. Palmer: Will the reporter read the Court's suggestion to the witness?

(The statement by the Court which Mr. Palmer referred to was read.)

A. I could name some of the main problems.

Q. All right, sir. Will you do that, please?

A. But as to whether it covers the situation, I don't suppose it will. One is that it must be determined the amount of equity that a contract holder would be allowed to be applied toward any adjusted contract. One of the main problems is determining the new contracts—con-[fol. 3394] structing the new contracts that are going to be offered to the present contract holders and as well to any prospects that may be contacted. Another problem would be for the company, after reorganized and after established, to obtain a license in each state in which the converted contracts are to be sold or whereby new business may be sold. Another problem would be to determine in each individual case as to how the equities which he received as determined by the Court or otherwise may be applied toward such new contract as accepted by the contract holder. It would be necessary to determine some method whereby those contract holders not accepting any of the contracts—the new contracts offered by the insurance company—as to how he may receive his equity. And of course it would be necessary to set out your entire operating plans of your new company, the basis from an operating standpoint—I might say that phase of it would have to be considered the same as if you were organizing a new company of any kind.

Q. Mr. Latta, did you tell us yesterday you had taken part in the reorganization of fifteen life insurance companies?

Mr. T. C. Townsend: He has asked that. Everybody [fol. 3395] knows that he did say that.

Mr. Palmer: All right, then.

Q. Then, Mr. Latta, can you tell us whether or not as an actuary these problems that you have suggested can in some part be solved by an actuary?

A. I don't know what you mean by solved. I would have to qualify that. I can qualify it by meaning what the effects and causes would be, but the degree of what the results may be, that is another question.

Q. What part did actuaries take in the attempted reorganizations of the companies with which you worked?

Mr. Ray: Your Honor, that is certainly irrelevant. He has gone into what actuaries do over and over again and I think he has testified as to what part he had in those reorganizations.

The Court: I think so too, but at the risk of repetition, I will overrule the objection.

Mr. Ray: He definitely said he supervised the actuarial work in those reorganizations. That was his exact language.

The Court: Well, now, I understand, Mr. Palmer wants to know what that actuarial work was that he supervised. [fol. 3396] Mr. Palmer: That is right, your Honor.

A. To give a definite answer to that—it is rather a broad scope—I will go back to my answer previously that as far as the reorganization covering the points I mentioned a while ago, it would cover those phases with the exception of the contacting in the field and making the sales of the conversions or the handling of the securities.

Mr. Palmer:

Q. And with the exception of the legal determination of the equities—it would not include that feature. By that I mean that the actuary could figure out percentages or proportions if some legal body would lay down the rules of law by which he should be guided? Is that correct?

A. Well, I think the actuary's work all the way through is necessarily guided by laws and rules laid down wherever the legality comes in.

Mr. Palmer: Now, if your Honor please, with those answers of the witness, I think the witness should be permitted to testify as to the method of solution with Fidelity of the problems which the witness has indicated.

The Court: You mean ask his opinions about that?

Mr. Palmer: Yes, sir, as to how that should be done.

[fol. 3397] The Court: I sustain the objection. This witness testified a while ago in answer to the Court's question that he took all those phases that he enumerated of the actuary's contacts with the different elements in a plan that might be set up—he took all of them into consideration when he answered my question that from an actuarial stand-

point a plan of reorganization could be framed. Now, that is, in my opinion, as far as this witness can go. He can't go beyond the actuarial phases of it.

Mr. Palmer: Still, if your Honor please, the Court has not permitted him to state whether or not from his experience as an actuary if he would do all that whether it would do any good and that is the point we are interested in.

The Court: We are just as qualified to form an opinion on that as this witness is so far as he has shown.

Mr. Palmer: How many of us have been in the reorganization of fifteen life insurance companies, if your Honor please, where we have had those problems and worked them out to see if they would be successful?

The Court: Well, I will have to sustain an objection to his opinion.

[fol. 3398] Mr. Palmer: Let the record show that if the witness were permitted to testify—

Mr. Ray: I object to this, your Honor. He is going to vouch an opinion which your Honor said he couldn't do.

The Court: No, I said he could vouch this witness's opinion all he wishes, but he is not permitted to vouch any facts in the record that the witness would testify to without first asking the questions about those facts and having it ruled on. You may state in the record, Mr. Palmer, whatever you wish as to his opinion.

Mr. Palmer: May I ask the Court's further protection also, since I can't get the courtesy from counsel, when I am addressing myself to the Court that counsel be instructed by the Court to wait until I have concluded my statement before they interrupt with the objection?

Mr. Ray: I am sure we would not have been interrupting if counsel at this end of the table didn't think you had made so many broad statements that shouldn't go into the record.

The Court: I will admonish counsel not to interrupt, because if the Court feels that anything of an improper nature is being said, the Court will do the interrupting.

[fols. 3399-3418] Mr. Palmer: Thank you.

Will you read what I said?

(Mr. Palmer's statement was read as follows: "Let the record show that if the witness were permitted to testify"—)

Mr. Palmer: (Continuing.) Counsel believes that the witness would say that it is possible in his opinion that as

to each contract of Fidelity, the equities can be, when the rules for determining the equities have been first laid down by a proper judicial tribunal, exactly determined and thereupon applied to each contract and that that contract can be revised as to actuarial set-up so that that particular contract can be liquidated, either immediately or slowly from the assets of the company.

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[fol. 3419] The Court: It would make a difference, wouldn't it, whether the securities were being managed rather than being just left where they are?

A. That is right. In the calculations in computing and determining a contract you are going on one theory of all life insurance companies, and I think it applies the same to a face amount certificate company, because the factors involved are identically of this nature. You are assuming [fol. 3420] that the company is operating as a perpetuity. For instance, you are not trying to determine when a security will mature, when it will be paid off, when it may or may be sold, and if sold, that the money received shall be reinvested. You are also assuming if in one case you are having new money coming in from one contract, that identical dollar, whatever way it is invested, has no practical relationship to the contract in question. For instance, we have \$10,000 here; we are talking about an isolated amount; that \$10,000 doesn't apply to any particular contract, but applies to all of them alike. Whether one contract matures, it doesn't make any difference in your assumption whether that money is from premiums, income just received, or whether it liquidated a security. In the valuation of securities as used by life insurance companies it is considered on a long term basis. That is one reason they do not use market values. In making a valuation of the solvency of a company they are not considering as to whether that contract will be sold today, because they have assumed that all of these policies are not going to be cash surrendered today, or they are [fols. 3421-3423] not going to be matured today. That is where your large number comes in again; it is operating as a perpetuity, assuming the same number of contracts in force whether one begins today and the other matures today, that goes back to the theory of a perpetuity in large numbers. That annuity, if you are going to determine just

how much they had, that they had \$10,000, like you said, or \$500 apiece. Now, there is no consideration to cover operating expenses. That would have to be taken into consideration.

[fol. 3424] Mr. Palmer:

Q. Suppose that today it would be decided to determine the proportion of the entire company that each contract holder was entitled to, that one would be entitled 1.52/80,000 and so forth of the company. In other words, there has been made a determination. Now, there is to be no new contract sold, no new payments paid in, but at the end of 10 years the fund is to be paid in its entirety to the contract holders at the end of that period of time, and during that time the securities are to be managed properly by a competent person to keep them so that they will return the greatest amount that can reasonably be expected when liquidated into cash. Now, what other factors in the way [fol. 3425] of operating expenses, in the way of the number of contract holders getting less and less each year, would be encountered in such an idea?

Mr. Ray: Your Honor, what is the pertinency of such an idea?

The Court: Well, I will overrule the objection to that.

A. I can't see where—exactly what is meant by it, except that the assumption is—Let me interpret your question and ask whether this is a correct interpretation or not. Do you mean what would have to be considered in order to liquidate this over a period of ten years?

Q. That is right.

A. That goes back to the liquidation again of a fixed amount. Now, as to being able to determine if a person had an equity of 85 cents today, to determine what he could get, then you have a large number of factors there that are speculative.

Q. Well, what are those factors?

A. Well, you don't know what those assets are going to liquidate for, even though you determine the market value [fol. 3426] today, then you are going into the speculation of what these securities bring over a period of ten years liquidating them 1/10th a year. Who knows which securi-

ties are going to be liquidated? Putting them in the form of statistics, you are getting away from the perpetuity entirely, and you must liquidate possibly 10 per cent each year. Now, whether the next three years they would liquidate correspondingly to the value as to what they would bring today has no relation to what the securities you are going to liquidate four years from now, except through speculation. You don't know whether they are going to be up or down or what the securities the individual decides to sell, or whether he sells the security today even at a loss compared to the value placed on that today. That is the one large speculation. Another is the interest factor, another is the expenses. You can't estimate what the expenses are going to be unless you know the nature of your setup. Just before, when I was talking about going into the expense of a reorganization plan, or what the company may be, you are assuming as a going life insurance company what the expenses are going to be according to the average or according to what can be expected. Now, as to what they are going to be, you don't know. When you are talking about a reorganized company you don't even know what the management is going to be, you don't know what the setup is going to be, you don't know what kind of people they are going to have. That goes back to taking the individual case and applying it to the general rule. You can't apply anything to this company, because as soon as you apply to the background of the company statistics do not apply. As soon as you change your basic information, it is like saying, "What can the profits be on this as a life insurance company as compared to a face amount company?"

The Court: Isn't there a short answer to what Mr. Palmer asks you, that actuarial calculations are never made on a liquidation basis?

A. That is correct.

Mr. Palmer: You spoke about expenses. As the number of contract holders decreased in the assumed case I have given you, the expenses per person must go up? Isn't that true—or is it true?

A. Well, in general, if you have a fixed company, we [fol. 3428] have a company operating—

Q. No, forget that, please, sir, and stick to my question.

A. I have to make some assumptions. Maybe I misinterpreted your question.

Q. Taking Fidelity today, taking the assets of it, and we are going to finish up with them in ten years we are going to pay off the contract holders as we go along during that period of ten years, now, as the number of contract holders gets smaller, isn't it true that the expense per person left in the group will be high?

A. You are going back to the same statement we made a while ago in making a statement as to what the expenses are going to be operating under a given plan. You are assuming you know what they are going to be.

Q. Will your expenses be higher or lower per person?

A. You are not operating?

Q. That is right.

A. We just stated a while ago that in making computations from statistical data you are not figuring on a liquidating plan.

Q. Well, figure on this liquidating plan. That is what [fol. 3429] I want you to do.

A. I can only assume by comparisons with a life insurance company or even Fidelity.

Q. All right.

A. If you take the same company with a hundred thousand contract holders, and whether those, through forced liquidation, voluntary liquidation or just "natural liquidation—that is, by natural liquidation I mean where the sales of new contracts are less than the maturing contracts of those who carried their contracts in—in other words, the normal operation of the business is decreasing as far as the number of contracts in force, yet a number of your expenses are fixed, such as the cost of the home office, such as managerial fees, in some cases, if it depreciated sufficiently, your expenses are coming down.

The Court: Are you talking about an operating company or liquidating.

A. Liquidating, whether it is voluntary or otherwise.

Q. Why do you think it is necessary to have a home office in case of liquidation?

[fol. 3430] A. Well, I said that I could only compare it to that, because we don't know under what conditions the company would be liquidated. That is to be determined. That is the reason I said I couldn't state a factor there.

The Court: Go ahead. I didn't mean to interrupt.

The Witness: That is all right.

Mr. Palmer:

Q. So that, as I gather it, your answer would be that the expenses, as the group grows smaller, are necessarily higher in proportion per individual in the group?

A. As a rule I think that would apply, because fixed expenses remain the same regardless of the number involved.

Q. When you take a large enough group, you can apply your totals based on past experience to that group, and you so do in your business? Isn't that true?

A. Yes, we apply it and then we compare the actual experience with what we have estimated.

Q. You would not, however, attempt to take one individual of that group and say, "These general rules should apply to that individual"?

A. When you are working on individual cases you apply [fol. 3431] the general rule, yes.

Q. As you come gradually down, where you get a smaller and smaller group, is it true that you come further and further from your general rule of averages?

A. That is true; the smaller your sample the larger your fluctuation from that which you predicted or expected.

Q. So that if you assumed at the beginning a given rate of interest, as your group got down lower and lower the possibilities of your assumption varying would be greater and greater. Is that correct?

A. That doesn't necessarily apply. I think it does to some extent, but the degree, as far as the interest on investments is concerned, it goes back to this, if you have two securities, one of them earning interest and the other is not, naturally only 50 per cent is earning interest; whereas if you had a large group you could still isolate them and pick them out where only half of them are earning interest. Large portfolios usually vary to a less degree because they are more or less constant. Again, you are getting away from liquidating.

[fol. 3432] Q. Now, Mr. Latta, with reference to forming Fidelity into a going life insurance company, one of the problems that you would have—one of the problems, I say,

—would be this question of the liquidation, slowly or rapidly, of some of those contract holders. Isn't that true?

A. That would be a question to be considered, and it would be different in each case of reorganization contemplated or each plan that would be contemplated.

Q. I say, in converting Fidelity into a life insurance company, you are going to have to have some of those contracts liquidated either immediately or slowly by virtue of this annuity plan or some analogous plan? Isn't that correct?

A. Yes, if you are going to liquidate over practically the limit of time involved in one contract, ten or eleven years, that is the life of them, therefore all of the contracts that are there now, assuming the practical question or the theoretical question, either mature or begin to mature within a period of ten years.

Q. Now, considering that you would take none of the assets of this company away from those former contract [fols. 3433-3437] holders, then the only way that you would have to get operating expenses under the new life insurance company to manage this voluntary or slow liquidation would be by virtue of the money you would get from new premiums? Isn't that true?

A. Yes, I would say that was true, unless you took it from the equity that was there now.

Q. I said, leave that equity there.

A. Oh, I didn't understand it.

Q. So, in other words, if you would turn Fidelity into a life insurance company and want to give each contract holder the equity that he now has, it would be necessary for new policy holders to pay for the liquidation of the old ones? Isn't that the substance of it?

A. Well, of course you are assuming that you are going to give it out to them in a fixed manner?

[fol. 3438]. Q. Now, Mr. Latta, with reference to converting Fidelity into a going life insurance company, there would be a certain percentage who would be insurable—that is true, is it not?

A. Yes.

Q. And there would be a certain percentage of those who would take out insurance. That is true, is it not?

A. I would imagine that would be true.

Q. That would necessarily consist of an agreement between them and the new company for a conversion of their equity in their old Fidelity contract into a new life insurance policy. That is true, is it not?

A. I believe that would be true.

Q. As to the balance of the group who either were not insurable or who were not inclined to take insurance, there would have to be some means of liquidating their equities in their Fidelity contracts. That is true, is it not?

A. That would depend on what you mean by liquidating.

Q. There would have to be some way of giving them money in exchange for their equities.

[fol. 3439] A. Naturally if you are going to give them their equity they have to have some means of receiving it.

Q. That is right. One way would be to sell the securities or assets which back up their equity and turn it over to them in cash. That is true, isn't it?

A. That is one way. That is liquidating the equity, I would call it.

Q. Another way would be the hypothetical way we discussed earlier of giving it to them over a ten year period. Isn't that true?

A. Yes, roughly.

Q. Sir?

A. Roughly, I would say.

Q. I want you to give me other ways which you would have of converting their equity into and returning cash to them?

A. Well, there would be a number of ways, but they would all range between a case of immediate liquidation and paying the equities as soon as the assets could be liquidated, and offering them in some form of annuity or some method of payment over a period of time, or to operate the fund [fol. 3440] or those assets over a period of time and then having a deferred liquidation.

Q. In other words, it would either be immediate liquidation, and by that we are speaking of selling the assets and converting them into cash and distributing that, or deferring that to a later period, or giving them some form of annuity or a combination, or giving them an immediate cash liquidation plus annuities and later deferred liquidation? Is that correct?

A. It could be any degrees, yes—any number of degrees.

Q. But those are the basic principles?

A. I would say yes, because annuities is a broad term.

The Court: It could be fixing the amount of their equity on a percentage basis and then just letting their contracts that they now hole mature, couldn't it?

A. That is true.

Mr. Palmer:

Q. And each of those would involve the various items of expenses that you have heretofore discussed?

A. Naturally you can't manage it and handle it without having expense, if that is what you mean.

[fols. 3441-3468] Q. And be subject to the risks of depreciation and appreciation that you have discussed?

A. I covered two or three elements a while ago.

Q. With reference to reforming Fidelity as a going life insurance company, it is true, is it not, that that part of the company which would operate to sell new life insurance and set up reserves on it would be, in effect, beginning as a new life insurance company, starting from scratch? Isn't that true?

A. Oh, they have no life insurance now, and the only way I can see would be starting one from scratch.

Q. There would have to be a capital structure or fund set up to begin with, wouldn't there?

A. In some way, otherwise you can't obtain a license to sell.

[fol. 3469] Mr. Palmer: If your Honor please, I ask that the testimony of Mr. John Marshall on his direct examination, Volume I, pages 429 and 430, to the effect that he thought a plan was feasible and that he never saw anyone who had ever made a study of the situation in our organization who did not feel that it was feasible and that he knew that that was the position of Mr. Arthur Koontz all these years—I ask that that testimony be stricken out. I further ask that the testimony of Mr. Pulfer, Volume II, page 788, as to the feasibility of a plan of reorganization, be stricken. I ask that the testimony of Mr. Messick, Volume II, pages 889-890, be stricken. I ask that the testimony of

[fols. 3470-3477] Mr. Young, also introduced by the debtor, Volume III, page 1423-7, as to the feasibility of the plan, your Honor, stating their opinion be stricken from the record.

The Court: Overruled.

[fol. 3478] Cross-examination.

By Mr. Farmer:

Q. Mr. Latta, who employed you, that is, what officer of the Fidelity company, to come down to Wheeling the first of January and do this work which you did?

[fol. 3479] A. I wasn't employed by Fidelity until February 12th.

Q. All right; February 12th.

A. As to whom I was employed by, I can't say. I was so informed—rather I had interviews with various officers, and my understanding was that they took that into consideration, and I was informed after tentative arrangements were made that it must be approved by the executive committee—

Q. Who were those officers that told you what the nature of your work was to be—your duties?

A. Well, the nature of it in general—general consensus was that I was to be an actuary and underwriter for the time being.

The Court: He said who told you that?

A. Well, the tentative discussions were made with Mr. Messick.

Mr. Farmer:

Q. Mr. Messick?

A. He was the first gentleman to contact me; he was the first officer.

Q. Did he tell you that the company was in financial distress and he wanted you to go down and see if you could [fols. 3480-3484] work out some plan of keeping it off the rocks, or words to that effect?

A. No, he didn't say that.

Q. No, not those exact words—what did he tell you, then?

A. Well, his inference was essentially this, that the com-

pany could no longer operate in accordance with the laws as a face amount company in the manner that it had in the past, and they as a group—I don't know who he meant by "they"—had exhausted their possibility and made a complete study of the matter and had decided that they wanted to reorganize the Fidelity Investment company as an insurance company, and since they had to change their methods of operations that they believed that the nature was similar and their best future would be based upon reorganizing as an insurance company, and they had contemplated a reorganization program by which, through some method, they could convert this into an insurance company, and that was the reason they were interested in having me come with the company—that was the basis of the whole conference.

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[fol. 3485] Q. If you have an insolvent company, of course, it is axiomatic that there are just two ways of obtaining a condition of solvency, either by increasing the assets from a source outside the company, or by effecting a reduction of the liabilities of the company so that the liabilities will correspond to the assets?

A. That is correct.

Q. Now then, what amount did you calculate, that is, in dollars and cents, that reduction of 15 per cent in the uni-[fol. 3486] form plan would be—roughly; I am not asking you to give it to me in dollars and cents.

A. Roughly it would be three and one-half million dollars.

Q. Did you and the other officers who worked on it, in suggesting this 15 per cent reduction, arrive at that percentage of reduction for the purpose of obtaining that given sum of three and one-half million, or how did you happen to take the 15 per cent?

A. Well, I think 15 per cent is set out in the plan—If you notice, you have two plans there; they are each different; and if you made five others—but in each case various factors were involved in determining which one would be given in typewritten form.

Q. Well, in each of them were you seeking to obtain the result of the release of about three and one-half million of liabilities?

A. Naturally we would have had approximately that amount, which, in accordance with the valuation of the assets as given in that exhibit, it would require that amount

in order to make the company solvent and establish it as a going concern.

[fol. 3487] Q. Your plans were formulated with a view of obtaining that goal—that end—is that right?

A. That was one of the purposes.

Q. One of the purposes?

A. Yes, sir. Now, for instance you made the statement as to what the purpose of the plan was there, and you read in substance. If you will note, it called for a transfer of both the assets and liabilities of the fund to the general fund. You also made an inference in that connection, that it was for the purpose of establishing a surplus in the general fund. Well, that is not true. The purpose of transferring it to the general fund was not necessarily to create a surplus to the general fund, which belonged more or less to the stockholders, but the income funds, for instance, the special income, had a deficiency which had no direct relationship with the 15 per cent, and the same way with each of the other funds. Whatever method of valuation you used, each fund would have a different degree of solvency. Therefore the only way that a uniform plan would mean anything in order to reduce the liabilities on a uniform basis, would be a consolidated plan whereby the results [fol. 3488] would be that all assets and liabilities would be consolidated. One of the purposes, primarily, would be to eliminate so many different funds, because of the great expense of operating those on a fund basis. In addition, each time you have a fund and you later decide to discontinue the issuance of those contracts, where there is no new contract holders belonging to that fund, then immediately that fund becomes upon a voluntary liquidation basis—I should say automatic liquidating basis—because every time a contract matures there is just one less, and it will over a period of years, liquidate; it is on a liquidating basis. Therefore, one of the objectives in that plan would be to eliminate the various funds that it now has. In each of those plans I think it called for—at least the purpose behind it would be to eliminate those funds.

Q. You say in each of those plans?

A. Yes.

Mr. T. C. Townsend: Eliminate which funds?

A. What I mean is, eliminate the segregation into special income and special annuity. I mean all the assets and liabilities would be in one general fund.

[fol. 3489] The Court: You mean eliminate the fund principle from the company's operation?

A. That is correct, and have all the operations just as the company, in one general fund.

Mr. Farmer: You say that was a feature or framework of each of the plans?

A. That is one of the basic principles, yes, sir, and that is the reason for transferring it to the general fund.

Q. That just made it convenient—the bookkeeping was separate?

A. Well, not only that, because, as I said before, each fund, whenever contracts are not being issued, it is automatically on a liquidating basis, and the contracts in establishing and setting up the contracts, they were not computed or determined to be on a liquidating basis, but on a perpetuity.

The Court: The result of that, as I understand your entire testimony, is that when a particular form of contract is discontinued, if that contract has been kept in a separate fund and thereby goes on a liquidating basis, it may, in the process of that liquidation, and without any other factors [fol. 3490] coming in, become insolvent?

A. That is true.

Mr. Farmer:

Q. Which had happened.

A. Which had happened. In other words, the history proves itself that that is what happens. You will note that the oldest fund in each instance is less than solvent.

Q. In other words, that was the history as exemplified by this company?

A. Yes.

Q. First income becomes insolvent and then special annuity?

A. That is true.

Q. And then the next one?

A. That has been true in every instance.

[fol. 3491] Mr. Farmer:

Q. Did I understand you to say, Mr. Latta, that there were six other plans besides these two?

A. No, I said several other plans that there could have [fols. 3492-3510] been put in there. I think you are referring to the 15 per cent, as to what was the purpose of using the 15 per cent?

Q. That is right.

A. I said there were several plans discussed and formulated. Each one was different, and there were various facts that entered into the reason for using the 15 per cent.

Q. Were the others all graduated plans, graduated like this plan you filed yesterday, except graduated on a different basis, that is, inflicting the loss in different ratios in the different funds?

A. There were different variations.

Q. And the problem is one of where the loss is going to be inflicted, isn't it?

A. That was one of the major problems, yes.

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[fol. 3511] Q. The Court this morning asked you this question—I think this is a correct statement of the question—would it be possible to—the word wasn't "formulate"—to construct actuarially a plan for reorganization for Fidelity, and your answer was yes.

A. That is correct.

Q. You did not mean to say that it would be probable to construct actuarially, taking into consideration all these other factors that you have delineated since that question was asked as being considerations that an actuary must give effect to in constructing a plan that would be feasible and would probably be successful in operation, did you?

[fol. 3512] Mr. Ray: We object to that, your Honor. That is asking for an opinion.

The Court: You were asking him if it was probable that a plan would be constructed?

Mr. Farmer: Just read the question, if the Court please.

(The question was read.)

The Court: I sustain the objection.

Mr. Farmer: On what grounds is there objection?

Mr. Ray: Giving an opinion.

The Court: You mean the grounds of sustaining the objection?

Mr. Farmer: No, the grounds of the objection. I assume it was sustained on the same grounds as the objection.

Mr. Ray: It asked for the opinion of the witness, which the witness is not qualified to give.

Mr. Farmer: If the Court please, I think the witness is qualified to explain his understanding of the questions and answers.

The Court: Well, you may ask him to explain, but you are asking him now whether he says now that it is probable [fols. 3513-3517] that such a plan could be constructed.

Mr. Farmer: That is exactly the point, your Honor. Your Honor's question asked him if it was possible to construct actuarially a plan for reorganization of Fidelity, and he said yes. Now I think the witness will answer that mathematically speaking it will be possible, but that practically speaking, considering all these other factors, which an actuary must necessarily take into consideration, that it would not be probable that such a plan could be constructed that would be reasonably expected to be feasible.

The Court: Well, that is just another and probably a clever way of trying to get his opinion. I sustain the objection.

Mr. Farmer: It is more than that, if the Court please. I deem that confined to the issue that your Honor must decide.

The Court: Well, I sustain the objection. I don't want to hear any further argument about it. I heard enough of that earlier in the day.

[fol. 3518] Q. Mr. Latta, since February 12th you have examined only the probabilities of reorganization solely from the viewpoint of a life insurance company? Is that correct?

[fol. 3519] A. It is essentially correct, yes.

Q. So that any testimony you have given today has been mostly from the background of rehabilitation as a life insurance company, not as a face amount certificate company or as any other kind of company into which the debtor might be reorganized? Is that correct?

A. That is correct.

Q. Are you aware of any federal court receiverships in Chapter 10 or 77B proceedings in which there has been a reorganization of a life insurance company?

A. I don't know of any, no.

Q. You would not say that there were not any?

A. No, I am not qualified to answer that question, except that I know of none.

Q. You have just testified about features of Series B. Would there be a greater loss by liquidation to Series B contract holders than by reorganization?

A. Well, if a person had no insurance contract—let me put it this way. In dollars and cents I can't see—it has no bearing, except that there is one feature in the B contract that, if you liquidate, all of those having insurance have lost their protection and could not replace that insurance [fol. 3520] protection in case they were not insurable. That would be an intangible loss that could not be valued in dollars and cents, and would differ with every individual.

Q. And if, in the interim from the time they signed a Series B contract until the time it was cancelled, they became uninsurable, that would be a tremendous loss to them, would it not?

A. If they wanted to keep that insurance, yes.

Q. So that if the debtor is reorganized, in fairness to the Series B contract holders, some kind of insurance would have to be included in the reorganization for those people.

A. Well, to prevent them from getting a loss, there would have to be some provision.

Q. That would be one of the equities to be considered—I mean courtroom equities distinguished from actuary equities?

A. I think that would have some bearing, yes.

Q. You have prepared Exhibits 113, 112 and 111, which are, as far as 111 and 112 are concerned, two of the seven plans that you worked on between February 12th and April [fol. 3521] 12th?

A. I didn't say I prepared these.

The Court: He didn't say seven.

Mr. Huwe: Did you say several or seven?

A. In the first instance, I didn't say I prepared these.

Q. You contributed to them?

A. Yes, I collaborated in their preparation.

Q. How many were there altogether, seven or—

A. I wouldn't state.

Q. Those were presented to the SEC?

A. Yes.

Q. As far as you know?

A. That is correct..

Q. And you were there?

A. That is right.

Q. Let me ask you, what is the standard of evaluating securities in insurance companies for purposes of rehabilitation? What standard is used?

A. For the purpose of rehabilitation I can't say there is any set standard.

Q. Isn't it a fact that the recognized standard is the in-[fol. 3522] surance conference method of evaluating securities?

A. Well now, that is not set up for the purpose of rehabilitation. As a going concern there is a standard set up by the Conference of Insurance Commissioners. They have set up a standard for evaluating the assets of an insurance company.

Q. Is there an insolvency standard?

A. In determining insolvency that valuation of assets is used.

Q. Would that be the valuation used for the purpose of reorganizing a company?

Mr. Palmer: I object to the question on the ground that the witness has just stated that that was used for a going concern method, which would naturally answer the question of the examiner.

The Court: Sustained.

Mr. Huwe:

Q. Then a going concern method would be the kind upon which a plan of reorganization would be based? Is that correct?

A. No, I stated that there wasn't a definite rule on that. The insurance standard valuation would be used in de-[fol. 3523] termining the solvency, which would be an assurance of your success for future operations at a later date. That is not necessarily used in a plan of rehabilitation. I have seen a number of methods used.

Q. What standard was used in 111 and 112—West Virginia sound standard?

A. I did not evaluate the assets. I have stated in several instances that I had no part in the preparation of the figures presented in those exhibits.

Q. The SEC refused to consider those plans because you took an assumed valuation rather than an actual valuation of some sort? Isn't that correct, or isn't that one of the reasons for criticism and rejection?

A. The criticism that I mentioned before was that they objected they did not believe that they carried the element—in other words, it wasn't sufficient—that the plan when put into effect, the results attained were not sufficient to be carried out. Their interpretation of the evaluation of the assets I don't know.

Q. One of their objections or one of their suggestions was that an umbrella of court procedure was required in order to prevent cash surrenders? Isn't that correct [fols. 3524-3527] rect?

A. In substance I think that is correct.

[fol. 3528] Mr. Huwe:

Q. In your graduated plans, did you ever determine what amount each fund had in the way of assets?

A. I didn't refer to my graduated plan. He was talking about a specific exhibit. I made no plan.

Q. The plan that you contributed to, marked Exhibit 111.

The Witness: Now, the rest of the question.

(The question was read.)

A. I have never been able to determine the solvency of any of the funds, if that is what is meant by the question.

Q. Did you, in your contribution toward these plans, consider the value of the National Sales Agency's notes?

A. I did not.

Q. You accepted the October 31—

[fols. 3529-3531] A. I didn't contribute to the figures presented in this exhibit. I believe, though, that it shows in that exhibit that the National Sales Agency note is considered at zero, with no value.

[fol. 3532] Q. You did considerable work with Mr. Ross Thomas, one of the state court receivers?

A. I did some, yes.

Q. What can you say as to his knowledge and ability of [fol. 3533] the workings of Fidelity and the laws and parts of laws connected therewith?

The Court: Mr. Palmer, I don't desire to cut you off or anything, but it seems to me that you are going back now on to a resumption of asking this witness to give testimony—I understood you were through a while ago with the main phase of it.

Mr. Palmer: That is correct, your Honor.

The Court: Is this something that will take another long period of time?

Mr. Palmer: I think one answer will suffice. I want this witness's opinion as to whether or not Mr. Thomas, as a lawyer, being a receiver, was capable of handling Fidelity as a receiver. In other words, this gentleman has worked with other attorneys and other receivers and I wanted to know whether his opinion was that Mr. Thomas was capable of acting as attorney in that receivership and as a receiver.

The Court: Has there been any challenge of that?

Mr. Palmer: There have been more or less indirect challenges whether Mr. Thomas was capable as a state court receiver.

[fols. 3534-3547] The Court: As to his capability I have heard none.

Mr. Palmer: If he is capable then I will withdraw the question.

The Court: All right. We have been talking about his suitability, not his capability.

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[fol. 3548] ARTHUR B. KOONTZ called as a witness by the Tennessee contract holders, having been duly sworn, testified as follows:

Direct examination.

By Mr. Farmer:

Q. This is Mr. Arthur Koontz?

A. Yes, sir.

Q. You are a practicing lawyer at the Bar of Charleston, West Virginia?

A. Yes, sir.

Q. And senior member of the firm of Koontz & Koontz?

A. I am.

Q. Do you have several members of that firm in addition to your brother, Mr. Pat Koontz?

A. Several associates, yes, sir.

Q. Mr. Ross Thomas, Mr. Campbell Palmer are associates? [fol. 3549]

A. They are.

Q. And Mr. Goldsmith, I believe?

A. Yes, sir.

Q. Mr. Koontz, how long have you practiced law in West Virginia—Charleston?

A. Since 1911.

Q. Have you had any experience in financial or banking matters or in connection with banks?

A. Somewhat. I represented a national bank the first ten years of my practice and organized a state bank and represented it as general counsel.

Q. State whether or not you at the present time, are a director of the Pittsburgh Joint Stock Land Bank?

A. No, I happen to be a director of the Home Owners Loan of Pittsburgh, the same in that field as the Federal Reserve is in the commercial banking field.

Q. Are you a director of a Charleston bank?

A. I am vice-president and director of The Charleston National Bank of Charleston, a national banking association.

Q. These banks that you testified about organizing—

[fols. 3550-3553] A. I organized the Union Trust Company in 1913 and consolidated the Union Trust Company and a number of other banks into the Charleston National Bank in the late twenties under the name of Charleston National Bank.

Q. And it is now the Charleston National Bank you are connected with?

A. That is right.

Q. State whether or not you also happen to be Democratic National Committeeman from West Virginia?

A. For the past few months, yes, sir, since about May or June, 1940.

Q. So that your experience in addition to legal matters or legal practice has been considerable in the line of financial matters?

A. That is true.

Q. Mr. Koontz, when did you first become connected in any way with Fidelity Investment company?

A. In the early thirties, I think it was '32, they asked me to do some work for them here.

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[fol. 3554] Q. Mr. Koontz, prior to that time had the directors of Fidelity had under consideration some sort of reorganization or recapitalization of Fidelity—that is, prior to 1938?

A. Not for the past three or four years just immediately prior thereto. They seemed to be doing a very good business in '36 and '37, and I don't remember that they had under consideration—under serious consideration in any way recapitalization.

Q. Prior to 1936 had it been under consideration?

[fol. 3555] A. It certainly had, from that on back to the early thirties the question of depletion of portfolio and reserves and so on. They would talk about trying to get new capital and how we might recapitalize and whatnot, but never did.

Q. What part had you to do, if any, with that effort during that period to secure new capital?

A. None whatever. None in particular. We discussed it at directors' meetings, and I was a committee member part of that time, probably all the time. They had two committees, one an executive committee and one a finance committee. I was on both of them part of the time, probably most of the time, but I never attempted to secure new capital for it before 1938.

Q. In 1938 did you commence efforts toward that end?

A. I did, beginning in December immediately after the SEC suit was filed in Michigan, I attempted to interest new capital and proceeded to try to interest new capital for—oh, about a year after that.

Q. Mr. Koontz, in your past experience had you had occasion, as an attorney, to take part in the reorganization of companies—had you had experience in reorganization lines?

[fol. 3556]

A. I had.

Q. Will you just state what reorganizations you had taken part in and acted as attorney in?

A. Well, I was receiver for some gas companies in Delaware, and we reorganized those companies. We reorganized here in Kanawha County some other gas companies, now known as the Cumberland group, and The Elk Horn Coal Corporation in a 77B proceeding in 1937. I was active in that in the federal court in Ohio. I was in federal court in Oklahoma City in connection with the reorganization of Consolidated Gas Company.

Q. State, if you will, what efforts you made in 1938 and following that to reorganize or procure new capital for Fidelity?

A. We had a director of Fidelity by the name of Grosseup who was connected with what is known as the Greenfield Banking crowd in Philadelphia, Bankers—not Bankers Trust Company, but Bankers Company, I believe is the name of it. Anyway, it is known as one of the Greenfield institutions; and through that connection we attempted to [fol. 3557] interest the Greenfield crowd—is that Bankers Securities Corporation? I believe that is the name of it. Mr. Grosseup happened to be head of that. That was the first group we tried to interest, and they were very much interested, and made a thorough investigation and talked for some time as though they were going to refinance the company and take care of whatever it needed.

Q. Was it your aim and your object to secure new working capital?

A. That is true.

Q. Operating funds?

A. That is true.

Q. That did not consummate?

A. That is true, it did not.

Q. Then did you make further efforts to secure new moneys?

A. Yes, sir, during the entire year, and probably on into the next year.

Q. What banking institutions or companies or individuals did you approach?

A. Lazard Freres in New York was one. We spent some time with them.

[fol. 3558] Q. Is that a brokerage house in New York?

A. It is, I think, an investment banking house.

Q. A large, well known, well regarded institution?

A. Yes, sir, very high class personnel, well regarded institution.

Q. Any others?

A. G. M. B. Murphy was another one.

Q. What is G. M. B. Murphy?

A. That is an investment banking house, not so large or so strong as the first one mentioned.

Q. What others?

A. I was trying to think of the order of them. Pell and company was another one.

Q. Is that the brokerage in which Mr. Hamilton Pell—

A. Mr. Hamilton Pell is the head of it, yes, sir. Some little Philadelphia life insurance company, the name of which I forget. I spent some time in Philadelphia—a very small company. Then a man by the name of Allebach in Cincinnati had an automobile finance concern, and got very much interested. He came to New York for meetings, came to Wheeling for meetings; somebody went to Cincinnati for other meetings there, and so on, and finally [fol. 3559] made some kind of contract with him.

Q. You mean the company did?

A. Fidelity—some arrangement whereby he was given an option for a certain time to come in on a certain basis. Never consummated.

Q. He was to put in new money?

A. He didn't put in any new money.

Q. He was to put in new money if that was carried through?

A. That is right.

Q. When did you see Pell and company?

A. I forget. I could check up, if that makes any particular difference.

Q. Was that in 1938 or 1939?

A. Late in '39, probably, or early in '40.

Q. Did those negotiations extend over a brief or long period of time?

A. No, they were right extensive negotiations. We had a number of meetings with them.

Q. And was that with a view to their putting new money into Fidelity?

A. It was, yes, sir. And naming some others, I tried [fol. 3560] to get the Lincoln Life Insurance Company people interested, because we had an arrangement with them whereby they carried insurance on a number of our contract holders; had a number of meetings with them.

Q. That is Fort Wayne, Indiana?

A. Fort Wayne, Indiana.

Q. Lincoln National Life Insurance Company?

A. That is right, Lincoln National Life Insurance Company.

The Court: Mr. Koontz, with reference to your negotiations with Pell and company, what was the rock on which they foundered?

A. Well, we have to earn so much money on reserves, they didn't think it was set up on a basis so we could earn that reserve requirement. It was 4 or 4½ per cent and 5 per cent, some of them, I think. They just didn't think we could earn that money under the conditions; and they wondered, since changing conditions, whether or not a company operating in this field might be successful in the future. It was just on general grounds.

Q. Did the fact that the assets of the company may [fol. 3561] not have been sufficient to cover all its liabilities have anything to do with the failure of those negotiations?

A. Your Honor, that is why we were negotiating, was to get money to supplement our common fund so that the company, no matter how these obligations were—could at all-possibly meet its obligations.

Q. It is now stated that the company is about 10 per cent insolvent on the basis of market values. I want to know whether that particular feature of it had anything to do with Pell and company not coming into it.

A. I don't know that that was discussed at all. Of course, we were going to have to have a very substantial amount of money; we talked about from one to two million dollars with Pell and company, and they talked about some smaller picture or Fidel, and talked about being interested in a half million dollars. I don't know whether it was the insolvency of some of these funds or the amount of money involved or the lack of soundness economically of the system or just what it was that caused them to turn it down. I would say a combination of them, probably.

The Court: All right: go ahead.

Mr. Farmer:

Q. You say you were talking about Fidel at that time? [fol. 3562] A. They talked some about Fidel, yes.

Q. Did they, or not, indicate a willingness to take over Fidel at that time?

A. Oh, they did; they indicated a willingness to do some financing in connection with Fidel to make it a larger company.

Mr. T. C. Townsend: During what time was that?

A. That was at the same time we were negotiating for funds for Fidelity; I don't recall the date.

Q. Do you recall the year?

A. Either late in '39 or early in '40. If that date is essential I can get the exact date that I was in New York with Haskins and Sells' man, Mr. Clarke, because we were there for several days.

Mr. Farmer:

Q. Did the directors of Fidelity look with favor on letting Fidel go — them at that time?

A. No, they did not.

Q. Did you have any other negotiations with another investment house?

A. Yes, that brings out another one, the Atlas Corporation, Floyd Odlum's concern. Odlum had been a director [fol. 3563] in this company formerly, and I worked with them for some weeks, and that wound up just like most of the others. Odlum was interested, he said, in taking over Fidel—take it over and liquidate it. He told me that he would take it over and just liquidate it rather than carry on the business.

Q. Where was Mr. Odlum?

A. Well, we speak of him being in New York. His office is actually across in New Jersey, either Newark or Jersey City.

Q. That was a corporation, one of the big companies?

A. Yes, that is true, one of the very large ones.

Q. And Mr. Odlum is quite a prominent man in financial circles—investment circles?

A. Yes, sir, legal circles and financial circles and so on.

Q. Investment companies?

A. Yes, sir.

Q. Holding companies and so forth?

(No answer.)

Q. Did you see anyone else in connection with the matter?

[fol. 3564] A. Mr. McCandless, the head of the Lincoln National Life, put me in touch with an old school friend and former business associate of his in Chicago whose name I forget. He managed for a number of years the Hearst papers and had had some insurance experience. I saw him for two or three days and he finally turned me over to what is known as the Chicago Corporation.

Q. What was the Chicago Corporation? Is that as big as it sounds?

A. The Chicago Corporation was organized about—oh, during the panic, as they say themselves, to take advantage of bargains. I forget the head of that. The head of it was formerly secretary to Mr. Cummings, who is head of the largest bank in Chicago, a man with some experience, and they were interested in looking into this for the reason that they had been asked not very many months before to refinance Investors Syndicate; they were very familiar with the general type of business; and they did look into this, asked me to submit all my reports, which I did, and finally decided that they did not want to go into it.

Q. State whether or not you negotiated with a Morris [fol. 3565] Plan bank?

A. I did, yes, for some time.

Q. Where were they located?

A. Well, over the country generally, but I negotiated with Mr. Arthur Morris, who is president of the New York bank, and is, I think, chairman of the board of the top company; the Morris Plan Corporation of America I believe is the name of it. I met with him and with his directors.

Q. Did he go into Fidelity?

A. Very thoroughly.

Q. Its operations?

A. Very thoroughly. He is another one that had some experience in his early business career of selling investment contracts, and he knew generally about the business, and he and his directors went into it very thoroughly.

Q. Did you see also the Cleveland brokerage firm of Otis and Company?

A. That is right. I did.

Q. Can you think of any others that you contacted which you have not already mentioned?

[fol. 3566] A. No, sir, I don't outside ones. I will say this, I had a meeting with the main business men of Wheel-

ing and talked it over with them. They appointed a committee, and a number of them talked this over with other members of the company. I didn't negotiate very much with them except I laid the plan before them.

Q. And what was that plan?

A. Well, the plan—no interest evidenced.

Q. No what?

A. I mean the result was no particular interest was evidenced by them in going into it.

Q. These negotiations with these financiers and investment men and brokers and insurance men throughout the company, you said, commenced in 1939 and extended over into 1940?

A. I said late in '38.

Q. Did there come a time when Mr. Allen G. Messick came on the scene and manifested an interest?

A. That is true; Allen G. Messick and a man by the name of Bernard Rosset—we spoke of them as Rosset and Messick, the way they were written in the various papers—from Chicago.

[fol. 3567] Q. How did it happen, if you know, that they began looking into the company?

A. Hal Pülfer, who was in charge of the sales office in Chicago, seemed to be the one that got them in it.

Q. You didn't contact them yourself?

A. No, not at all. I think he and Messick were probably schoolmates. Knew each other at school, possibly.

Q. Did you have any part in the negotiations with Mr. Messick and Mr. Rosset that led to the drafting of this contract that has been filed here and introduced in evidence, referred to as the Messick contract?

A. Yes; I don't know what the contract is that has been introduced in evidence, but I did have considerable part in the negotiation with Rosset and Messick which led to their coming to Wheeling and entering into a contract which called for putting up a substantial amount of money upon certain conditions, a half million dollars as I remember is what they were committed on, if certain things were true and so on.

Q. Their plan was, was it not, that they were going to capitalize a new company separate and distinct from Fidelity?

[fol. 3568] A. That is true.

Q. With a half million dollar capital?

A. That is true.

Q. And issue new certificates and assume such liabilities of Fidelity on old outstanding certificates as the new company, at its option, might elect to assume.

A. That is true.

Q. And sell through the existing sales force of Fidelity?

A. That is generally what the plan was.

Q. The idea was that the new money that they put in would not be subjected to the risk that it would be if it were put in the old company?

A. That is right.

Q. Do you know the reason why that contract was not carried out—why that plan fell down?

A. I don't know the exact reason. I know there seemed to be some misunderstanding and scrapping between Rosset and Messick themselves. I don't know whether any notice was served on the company which gave any particular reason for their not going ahead with it or not.

Q. Did you know that Mr. Rosset brought a suit in Chicago against Mr. Messick charging breach of contract and seeking damages for his failure to carry that out?

A. I didn't see the praecipe or the declaration. I heard that that was true and saw some correspondence on it.

Q. I believe Fidelity was also made a defendant in that bill?

A. That is true.

Q. Did Mr. Messick later become connected with the company after that?

A. I don't know whether it was later. He did become connected with the company as chairman of the board, I think was his title. I am not sure but what that was before the filing of the suit. In fact, I think it was.

Q. Who was Mr. Rosset? Do you know what business he was in?

A. Mr. Rosset is a banker. He is head of what is known as the Metropolitan Trust Company. It is not a regular commercial bank; it is a trust company.

Q. Of Chicago, Illinois?

A. That is right.

Q. Do you know what Mr. Rosset charged in his bill seek-

[fol. 3570] ing damages from Mr. Messick for failing to carry out his contract—what his contention was about it?

A. You mean in the million dollar suit?

Q. Yes.

A. No, sir, I do not. I have never seen the declaration, if there was one filed.

Q. What was the reason for Mr. Messick becoming connected with Fidelity as long as the contract was not carried out, do you know?

A. No, I don't; I wasn't around Wheeling very much at that time, and I wasn't present when he was elected chairman of the board. I don't know how that came about.

Q. Do you know what services Mr. Messick was rendering to the company at that time that caused him to commence drawing a salary?

A. No, I do not. He was getting familiar with the affairs of the company when he was negotiating for Rosset and himself, and the next thing I knew he had been chosen chairman of the board of Fidelity.

Q. That was in 1940?

A. 1940. I am not sure of the month.

Q. And your negotiations with all these other men and [fol. 3571] houses—investment houses, bankers and so forth—that you have outlined occurred prior to the time that Mr. Messick became chairman of the board or not?

A. Yes, that is right.

Q. After he became chairman were the efforts continued to secure new money, that is, after the deal with him and Mr. Rosset fell through?

A. I understood from him when I would see him occasionally that he was attempting to secure new money or a reorganization of some kind. I have not been active—

Q. I believe your firm, or Mr. Ross Thomas, did considerable work for the company with a view toward compliance with the Investment Companies Act of 1940 prior to the time that that act went into effect, which was January 1, 1941. Is that true? Were you familiar with that?

A. Well, in connection with the registration statement that work was done in 1939.

Q. In 1939 he did that?

A. Yes.

Q. Did you, or any member of your firm, have anything to do with advising the company on matters of that kind [fol. 3572] with reference to the applicability of its attempt

to operate under the Investment Act of 1940? I do not mean applicability; I mean whether or not the company would attempt to operate under the Investment Act?

A. That is right. The registration statement was prepared in 1939, sir. The Investment Act became effective later than that, as I remember.

Q. Became effective?

A. With the advice of the company I registered with SEC before the effective date of this instrument we are talking about.

Q. Did you or any member of your firm assist the company in the legal matters of amending its charter so as to get the authority from the State of West Virginia to engage in the life insurance business instead of the investment certificate business?

A. We did.

Mr. T. C. Townsend: I object to that question and the answer. That is not what the charter did, and that wasn't the purpose of the application. That is, that is not what the amendment to the charter did; and that wasn't the purpose of the application, to substitute life insurance for an [fol. 3573] annuity company. It is all in the evidence here. All that charter did was to take on, in addition to what they already had, the feature of life insurance.

The Court: Overruled.

Mr. Farmer:

Q. Mr. Koontz—

The Witness: May I elaborate on that answer?

Mr. Farmer: Yes, sir.

A. I am not sure as to who drew that charter. As I remember, the amendment of the charter was drawn in the head office and was sent to us to file with the Secretary of State. As I remember, that was the way it was handled; we didn't actually do the work, make a study of the amendment, and so on.

Mr. Farmer: I ask this question because I don't recollect clearly. I did think that that amendment had been put in, and of course it will speak for itself—was already in evidence.

Mr. Palmer: Yes, it is in evidence in the minute book, is it not, Mr. Jaegerman?

Mr. Jaegerman: It is also in evidence in the charter, I believe, one of the documents—

[fol. 3574] Mr. Farmer: I thought that was one of the first documents filed.

The Court: If it is not in evidence it ought to go in.

Mr. T. C. Townsend: There was a copy of the charter put into evidence, your Honor.

Mr. Farmer: Well, it will speak for itself and decide whether my recollection is right or whether Mr. Townsend is right.

Q. Now, in 1941, after the Investment Companies Act went into effect and after the company had ceased to sell any new investment certificates, did you take any part in the consideration of plans for carrying on the operations of the company as an insurance company, and if so, state just what you did?

A. Well, its charter had been amended and they had hoped to start writing life insurance, but they were never able to get the green light from the Commissioner in Charleston. Various statements were worked on, various information asked for by the Commissioner from the company, some of the auditors came to our office with blanks and asked us to help them fill out those blanks, various [fol. 3575] work of that sort with a view of preparing the company to go into the business of life insurance if the statement, in the Auditor's judgment, showed that it should be permitted to write life insurance. We were in general touch through that last period.

Q. Did you attend any conferences at which representatives of the Securities and Exchange Commission were present where there was discussed possible plans for reorganizing the company?

A. Yes, I visited individually with some individual members in and around the Securities and Exchange. I went and had a conference with Mr. Risley at Mr. Schencker's office, at which Mr. Schencker was present and two or three of his assistants whose names I forget, except a Mr. Carver; and then we had a general town meeting, I think it was on March 17—I believe that was March 17th, as I remember.

Q. You say a general town meeting. What town is that?

A. I mean quite a conference in the general counsel's office. We had people from various sections of the SEC, [fol. 3576] had the Chicago representatives of Fidelity and

Wheeling representatives, and I believe Mr. Goldsmith was with me. Many people there. I don't know how many.

Q. Was Mr. Latta present at that meeting?

A. Mr. Latta was present, yes, sir.

Q. I believe it has been testified by Mr. Latta, if I am not in error, that that meeting in Washington was on April 1st. You said that you attended the meeting on March 17th. Did you attend two meetings or one meeting there?

A. Wait a minute. I am pretty sure there was a meeting on March 17th, rather large meeting. These gentlemen should be able to straighten us on those dates. I did meet back in Washington again early in April.

Q. Then you attended two meetings? Is that right?

A. I attended more than two meetings, but I—I attended that one large meeting, which I thought was—I thought was March 17th. I have some correspondence about it from Mr. Schencker and a copy of a letter from Mr. Jaegerman, Mr. Jaegerman asking Mr. Risley for certain information.

Q. Will you refer to that—

[fol. 3577] A. If I can find it. I just remember those letters. (Witness looks through papers.) The one in Mr. Lane's office, Mr. Sims was there, by the way, and I think Mr. Justice. A letter from Mr. Schencker dated March 12 asked us to be there on Monday afternoon, March 17th, at 2:30, and I replied that I would be there. I don't remember that that date was changed. Copy of a letter from Mr. Jaegerman to Mr. Risley, which was sent to me—that is dated March 13th and he asks Mr. Risley to bring certain information.

Q. Asked him to bring certain information for the meeting of March 17th?

A. For the meeting of March 17th.

Q. Is that the town meeting that you were talking about?

A. That was the large meeting.

Q. And Mr. Sims was there?

A. Yes, sir.

Q. And Mr. Harlan Justice was there?

A. Yes, sir, Mr. Sims I know was there, and as I remember Mr. Justice was there.

Q. You said you were also present at a meeting at which [fol. 3578] Mr. Latta—

A. Mr. Latta was at that meeting, as I remember, too. Mr. Latta was at that meeting.

Q. Could you establish from your files whether or not you attended a meeting before the SEC on April 1st in Washington?

A. I was in Washington April 1st on Fidelity's business. I don't remember whether that was the day I was over at the SEC or not. I as an individual went and conferred with some of the people from SEC from time to time by myself.

Q. Do you recall whether or not Mr. Goldsmith went with you on April 1st?

A. No, sir, I don't about that date. Mr. Goldsmith was with me a trip or two. Mr. Goldsmith was with me one trip when Mr. Latta was present.

Q. Do you recall that Mr. Latta, Mr. McNulty and Mr. Risley were present at that meeting?

A. They were. I mean they were at a meeting. I don't know whether that was the meeting of April 1st.

Q. State whether or not at one of those meetings at which Mr. Latta was present he had some plans that he [fol. 3579] had prepared, rather elaborate plans—he didn't prepare them, but that had been prepared up there that he had collaborated with the officers of the company in plans for reducing the contract liability or cash liability to your contract holders by—

A. That is right, he did.

Q. By taking off 15 per cent, or something like that, from them.

A. Taking off a certain percentage all the way across the board, or taking off different percentages of different contracts and so on.

Q. And you were there at that conference when those ideas that he had, or plans, were laid before the members of the SEC and discussed?

A. That is right, I was.

Q. Was Mr. Jaegerman present at that meeting?

A. Mr. Jaegerman was present at the only meeting at the general counsel's office, I know, I remember that we were. I don't know about these various conferences, I don't know who was at all the conferences, except I remember that large conference that Mr. Jaegerman was there.

Mr. T. C. Townsend:

[fol. 3580] Q. That was the March 17 conference?

A. I think so. That is what my correspondence shows, and I don't see anything that would indicate that that was changed from that date.

Mr. Farmer:

Q. What was the attitude expressed by the representatives of the SEC at that meeting at which you discussed those plans Mr. Latta had with him there—that is, the attitude of the SEC toward those plans?

A. Different attitudes by different members, just as there were different attitudes with different members on our own side. It was a question whether or not you should take a uniform percentage or whether or not some of the funds were solvent and they should let them alone or cut them down a very small percentage and take the large percentage off the others; and we broke up without having any particular conclusion on any plan.

Q. State whether or not the chief concern of the company, or the main pressing problem, was these maturing contracts of the old first issued contracts, special income and special annuity?

A. That is true.

Q. The drain on the company's cash position?

[fol. 3581] A. That was the main concern, of course, of the company, and also of the Commissioner and also of the SEC.

Q. Was it contemplated at that meeting, was it discussed, about court proceedings at that time, that the company would go into court?

A. Yes, we referred a number of times during the discussion to a proceeding of some kind that would be necessary to protect the company. That was discussed.

Q. Was there a discussion about what court the proceedings would go into?

A. No, a general discussion as between state court and federal courts. I don't know that any particular federal court was mentioned, if you mean it that way, a discussion as between state and federal courts.

Q. That is right.

A. That is right.

Q. What was the attitude of the SEC? Was it in a position of impartiality or did they have some partiality about it?

A. No, I didn't see any partiality about it. They always took the position that "that is a matter for you to decide; you are to choose your jurisdiction." I had discussed it [fol. 3582] not only that day but a number of times with a number of them and their decision always was, "We cannot decide for you what your jurisdiction should be."

Q. State whether or not at the time you had that conference it was recognized by the directors of Fidelity that some definite action must be taken without delay looking toward the rehabilitation of the company?

A. It was recognized by the members of the company and it was recognized and so stated by Mr. Sims, who was present, and seemed to be recognized by the members of the SEC who were there.

Q. Did you get a letter from Mr. Sims dated March 25, 1941, notifying you in effect that something must be done, otherwise he would be forced to cause proceedings to be instituted by the Attorney General's office?

A. Yes, sir, I got a letter the latter part of March; I don't remember just what the date was. I believe I have the original of it here, sir.

Q. A copy of that has already been filed as Exhibit 94. Have you got the original letter?

A. Dated March 25, yes, sir.

Mr. Palmer: There was a copy of the copy filed, which [fol. 3583] was questioned, and I promised that would be connected up later, your Honor, and I would like to have the original go in the record, if possible, to make good my promise.

The Court: If Mr. Koontz wants to part with the original it may be put in evidence in substitution for the copy.

Mr. Farmer: Without reading it carefully, it appears to me to be the same. Do you agree, Mr. Ray, that the copy is a correct copy of the original or copy that has been filed?

Mr. Ray: It seems to be.

Mr. Farmer: Then it is stipulated that the copy is a correct copy of the original, and Mr. Koontz need not file the original?

Q. Mr. Koontz, those plans that Mr. Latta—that he introduced yesterday or day before, when Mr. Latta was on the stand—those plans that were referred to about taking 15 per cent level off all of them or distributing the loss among the various contract series—appear not to take into consideration the fact that the company's assets had been deposited—practically all their assets [fol. 3584] had been deposited with state officials in various states to secure the liabilities in those states. What consideration was given to that situation in your discussion?

The Court: If any.

Mr. Farmer: If any.

A. I am not sure what that discussion was, offhand. I don't remember that there was any discussion on that line. I don't remember that there was any consideration given to that, except this one thing: in West Virginia it was—everybody knew that there was a surplus in West Virginia, but that deposit was made to secure contract holders outside where no deposits were made or where insufficient deposits were made. That was always recognized in all these discussions.

Q. There have been filed here, Mr. Koontz, some descriptive booklets that the company issued and used in connection with the sale of its Series B income reserve contracts, filed as Exhibits 85, 86 and 87, setting out certain financial statements and other statements with reference to state deposits, the company's business and so forth. Had you had anything to do with those descriptive [fol. 3585] booklets?

A. Prepared when, sir?

Q. Well, I will hand them to you. In 1939 and 1940, I think, after the Detroit proceedings.

A. We were consulted from time to time about notes to be put on the Auditor's reports, explanations to make, so that we would not be in—violate the injunction of the Detroit court, and to that extent we did have something to do with the preparation of the statements made after that Detroit proceeding.

Q. When you all were working on these plans, having conferences with the SEC, were you cognizant of the fact that the securities in these reserve funds—various securities in the reserve funds—had been deposited with state

authorities and were subject to the requirements of the state with respect to all the contract funds of Fidelity Investment Association, and if those funds were not held for the sole benefit of the holders of the particular contracts as stated in this descriptive booklet filed as Exhibit 85 on page 11, note 4?

The Court: Mr. Farmer, it seems to me that you are assuming something there that is a question for legal de-[fol. 3586] termination. Although there has been no objection to this question, I don't feel that there ought to be any such assumptions made. You may ask him if he was cognizant of the fact that that statement is in the booklet, but if you are assuming that statement to be true as a matter of law, it may be subject to some question.

Mr. Farmer: I will reframe the question in accordance with your Honor's suggestion, although I am still of opinion that that is a fact.

The Court: I understand that is your contention, but there may be other contentions of other attorneys. Go ahead.

Mr. Farmer: Of course, nobody has made any yet, in the proceedings that I have heard.

The Witness: Are you going to reask the question?

Mr. Farmer: I will try to state it again. Were you aware of the fact when you had those conferences discussing those plans that that statement that I referred to was in that descriptive booklet?

A. Yes, I knew about this statement in the descriptive booklet, of course. I don't know that it occurred to me [fol. 3587] at the time we discussed the latter plans, but I knew of this.

Q. When those booklets were prepared by the company and sent out for use in 1939, after the Detroit proceeding, did you have any conferences with any representatives of the SEC regarding those booklets and regarding the accuracy and sufficiency of those descriptive statements in the booklet?

Mr. Jaegerman: Your Honor, when those booklets were first offered there was a discussion about that. May I ask Mr. Farmer the relevancy?

The Court: I think I will overrule any objection to it, anyhow, so go ahead.

A: When the first statements were prepared there were some representatives of the SEC in Wheeling, Mr. Jackson and someone else whose name I don't recall, and of course they always took the position they couldn't advise us on how to prepare a booklet, but they were very kind in saying, "We see no objection to that. Of course, that is our idea. There is no objection to that so far as we know;" and the first statement was put in after advising with them. Later [fol. 3588] on, when Haskins & Sells came in and made the audit, it seems they had had a great deal of experience preparing the booklets, and they talked over with us the various notes which were attached to these statements, and they kept in touch, and did keep in touch with the SEC, and Mr. Clarke and I made a special trip to Washington once and went into the SEC relative to this.

Q. Mr. Clarke, you say?

A. Mr. Clarke, who is manager of Haskins & Sells. He is the one that finally gave the clearance on this booklet, Clarke of Haskins & Sells.

Q. Who did you confer with at the SEC about it?

A. I usually conferred with Mr. Kline or Mr. Lane, but I don't think they purported to pass on this. Mr. Clarke knew the contentions of the auditors, and I was in to see Mr. Andrew Jackson, head of the—I am not saying I conferred with him about this; some auditor from Tucson, Arizona—I don't remember his name—but Mr. Clarke being the one who was familiar with the auditors, was the one that did the talking on this, and we had given him our judgment on whether or not this statement violated any part of the injunction order in Michigan, and we were merely talking [fol. 3589] further with the SEC.

Q. Mr. Lane was general counsel?

A. Yes, but Mr. Kline was the man generally in charge of this. Sometimes he referred us to somebody else.

Q. Will you state, Mr. Koontz, how anyone there at that meeting expected to consummate a plan like one of those presented by Mr. Latta that he had there with him, the situation being as it was with reference to those deposits in the states?

A. How anyone at our meeting in Washington expected that?

Q. Yes, sir.

A. Well, that plan was a new plan and not very many people were very familiar with it.

Q. Had you seen it before you were there?

A. I am not sure that I did. Doubt if I had seen his completed plan. I had heard some talk about it over the phone, or probably had some second hand reports. I don't believe I ever saw the plan called the completed plan till I went to the Washington meeting.

Q. Well then, will you state, in your own words, the result of the last, final conference that you had with the SEC before the proceedings in the state court occurred?

A. What was my last conference? I remember very well the general result of our big meeting. I talked to some men around the SEC after that, some individual men. I am not sure whether I had a conference after March 17th. Maybe I had one—I was there on April 1st. I can't get my dates straight on that. I can give you the general result after the March 17 conference: "No definite conclusion."

Q. I want to ask you this, Mr. Koontz, because Mr. Latta has stated on the stand that he attended one conference on April 1st, and you have stated that you thought he was at the March Conference or the town meeting that you referred to on March 17th. There seems to be that conflict between the recollection of you gentlemen to that extent. Can you make sure that that meeting was held on March 17th, or is there any likelihood that it was postponed or it was not held until April 1st? Can you be positive about that?

A. No, but I feel sure that I have in my files somewhere a list of the names of the people who attended that conference. I think I jotted it down.

Q. The March 17th conference?

A. Well, whenever it was. It was called for March 17th.

Q. Would you mind doing that?

A. I will have to do that back at my office. I don't think I have it with me. I am not sure that I have, but usually after those conferences I marked down—

Q. I would like to clear that up, if I can, in some way.

A. Excuse me just a moment.

Mr. Farmer: Mr. Jaegerman, maybe you can clear it up and give us your recollection. Did you attend two such meetings?

Mr. Jaegerman: I attended more than two.

Mr. Farmer: More than two at which Mr. Latta and Mr. Koontz were present—I mean two at which they were present?

Mr. Jaegerman: I don't remember how often Mr. Latta was present.

Mr. Farmer: Have you got anything that would enlighten us about the March 17th meeting or the April 1st meeting? [fol. 3592]

Mr. Jaegerman: What is the difficulty about the dates? What are you trying to prove?

Mr. Farmer: I stated to Mr. Koontz the reason I wanted to clear it up, because there is some discrepancy between Mr. Latta and Mr. Koontz, and evidently one of the other is mistaken.

The Court: Do you regard the question of date as being of any importance?

Mr. Farmer: No; I don't regard it as being so terribly important, except that Mr. Latta testified that those plans were prepared by him the night before the meeting of April 1st, and Mr. Koontz had not seen them, and he only attended one meeting, and apparently Mr. Koontz's recollection was the other way, that there were two meetings at which Mr. Latta was present.

The Court: You can't change that testimony so unless there is some importance about the date of the meeting, let's go ahead.

Mr. Farmer: In fairness to Mr. Koontz, I thought I should—and I told Mr. Jaegerman to give us his recollection about it, if he had any notes or information about the [fol. 3593] meeting.

Mr. Townsend: He didn't say he didn't have any information about it.

Mr. Farmer: Would you mind, Mr. Jaegerman, stating your recollection of the facts?

The Court: I think you had better just go ahead, Mr. Farmer. We don't need to get a lot of stuff on the record about some discrepancy—

The Witness: I was invited to Washington on the 17th; I was in Washington on the 17th on Fidelity business, so I just assume it connects. There is a Securities and Exchange Commission letter here. I know—I feel sure we had that meeting on April 17th. I was in Washington again on April 1st. I don't remember what meeting that was, though, whether an individual meeting, whether it was with Latta and probably two or three others or what. The big

meeting, I feel sure, though was the 17th, because I see nothing that would indicate any change of that date.

Mr. Farmer:

Q. I will ask you this. After the final meeting, the April 1st meeting, was any definite decision reached about whether [fol. 3594] the company voluntarily, of its own initiative, be able to work out any sort of plan that would enable it to carry on business?

A. A decision was arrived at to the effect that it could not carry on or did not see how it could carry on. It was not doing business—it was not permitted to do business, and Mr. Sims had stated to them that he wasn't going to permit them to do business unless there was a change in the situation.

Q. Then were you notified later that Mr. Sims had called on the Attorney General to institute proceedings in the Kanawha County Circuit Court?

A. I was, yes. Mr. Sims wrote me that letter, and I checked with the Assistant Attorney General relative to these jurisdictions relative to this matter in general, and we started doing some work on it. I notified Mr. Foulk at Wheeling about it; I notified Mr. Marshall at Washington.

Q. Was a directors' meeting called about that time?

A. I understand so. I wasn't a director, and so, of course, I didn't get their notice. I won't say I wasn't told that there would be one. I understood there was one.

[fol. 3593] Q. Were you furnished with a copy of the resolution authorizing Koontz & Koontz to represent the company?

A. That is right, we were. I have forgotten what that date was, though.

Q. Have you got that with you here?

A. Yes. We were notified that we were appointed counsel to represent Fidelity in the proceeding which we are talking about—notified by letter.

Q. Who notified you?

A. Mr. J. F. McNulty, vice-president and secretary, wrote April 10th as follows:

“Koontz & Koontz, Union Building, Charleston, W. Va.

GENTLEMEN:

This is to advise you that the board of directors of Fidelity Assurance Association, at a meeting held on April 7, 1941,

at which a quorum was present, authorized the employment of your firm as counsel to represent this association in the pending suit instituted by the Auditor and ex-officio Insurance Commissioner of the State of West Virginia. The formal resolution as adopted by the board is as follows:

[fols. 3596-3597] " 'Upon motion of Mr. John Marshall, Sr., seconded by Mr. F. H. Pulfer, the law firm of Koontz & Koontz is authorized to represent the association in the pending suit instituted by the Auditor and Ex-officio Insurance Commissioner of the State of West Virginia'."

Q. Did you appear and represent the company—make your appearance?

A. Someone from my office did. I accepted service for the company and appeared for the company.

[fol. 3598] Mr. Farmer:

Q. You said that Mr. Sims was at this conference in Washington, whether it was March 17th or April 1st. Were you familiar with any sort of ideas or plans that Mr. Sims had for rehabilitation of the company or converting it into a life insurance company, what his ideas were, whether they corresponded with those of the company or not?

[fol. 3599] A. I don't remember that he had any particular ideas about rehabilitating the company. He was leaving that as the task for the company, that he was not going to let them start writing life insurance until the company got in such shape financially that they could make a statement that would justify his permitting them to start business.

Q. Well, at these conferences that you had before the SEC. were the only plans—I don't want to ask a leading question—state whether or not the only plans under consideration were plans with a view of the company continuing in business as an insurance company and not a face amount certificate company.

A. The company had just changed its charter and expected to continue in business as an insurance company handling this business of face amount certificates, if it handled it, as a side line rather than as the main object of the corporation, like some insurance companies that were mainly insurance companies but did write contracts.

Q. Did you know anything about the directors of the company appointed a so-called reorganization committee? [fol. 3600] A. I heard of that only. I wasn't present at the meeting where that was done. I heard there was one and Mr. Messick was a member of it. He told me that he was chairman of that, I believe.

Q. Mr. Allen Messick?

A. Yes.

Q. Did you talk with him about it?

A. I did. He told me——

Q. When did you talk with Mr. Messick about that?

(No answer.)

Q. That is, after the state court proceedings or before?

A. It was shortly after he was appointed. I saw Mr. Messick in Washington April 5th, I believe is the last lengthy conference I had with him. I talked with him a number of times by telephone, however.

Q. Were you acquainted with Mr. James R. Fleming?

A. I am, yes, sir.

Q. When did you first become acquainted with Mr. Fleming?

A. Sometime early this year. That is 1941.

Q. Prior to the state court proceeding?

[fol. 3601] A. That is true.

Q. How did you become acquainted with Mr. Fleming?

A. In the station at Washington, Mr. Messick introduced me to Mr. Fleming. I was getting off of an early morning train waiting for a taxicab, and Mr. Fleming happened to be getting off the train, as I remember, from somewhere else, and Mr. Messick introduced me to him.

Q. Did you have any conversations with Mr. John Marshall after the state court proceedings with reference to this proceedings?

A. A number, yes, sir.

Q. Where did you have those conversations and state what they were.

A. Well, I had a great many conversations with him, and most of them were in Washington, unless I was conversing with him by phone. I was in Washington a great deal during the early part of this year. I saw him every day for several days.

Q. Did Mr. Marshall express any dissatisfaction with the course of the proceedings, the fact that they were in the state court rather than in the federal court?

A. No, none whatever. He did raise this question: he [fol. 3602] said that there were some people that thought this proceeding should be in the federal court.

Q. Did he say who they were?

A. No. Finally it developed that Fleming was one that felt that it should be in the federal court.

Q. You say it finally developed?

A. That is right; that is right. I had a meeting with Mr. Marshall and Mr. Fleming in Washington.

Q. Do you know who Mr. Fleming was representing at that meeting?

A. Yes; if you will permit me to clear that I will go back and say that Mr. Fleming came to my office prior to our Washington meetings.

Mr. T. C. Townsend:

Q. Here in Charleston?

A. Here in Charleston, yes, sir.

Mr. Farmer:

Q. How did it happen that Mr. Fleming came—at whose request?

A. He had been put in touch with this situation by Mr. Messick, who is a very good friend—and again a college friend, I think classmates; they seemed to be very close friends—Messick and Fleming—about May 1st Mr. Fleming came to my office.

[fol. 3603] Q. Here in Charleston?

A. He had phoned me some days before from Fort Wayne and asked whether I would be home and so on and said he wanted to see me and talk to me about this matter; that Mr. Messick had been talking to him and had gotten him interested; and he did come, as I remember, on May 1st.

Q. He came down here to Charleston?

A. Yes, sir.

Q. To a conference at your office with you?

A. Yes, sir.

Q. Was anybody else present at the conference?

A. No, just the two of us.

Q. What was the discussion about?

A. The general situation and what it would take to rehabilitate the company, to put it in shape to do business. He talked to me about his conference with Messick—and

by the way, before that Messick had advised me by phone several times before that he had succeeded in getting Fleming interested in getting him actively to go into the company or the reorganization plan and could get a substantial amount of capital, if need be could get a million dollars. [fol. 3604] That was Messick; and then Fleming came over for a conference.

Q. Was that after the Rosset and Messick deal fell down?

A. Oh, yes.

Q. He still had capital, did he?

A. Yes, from another source entirely. That was this year. We are talking now about this year. So Mr. Fleming did come to the office for a conference, and he said, if you care to have me—

Q. I would like for you to go on and give us—

The Witness: Any objection to the result of that conference, your Honor?

The Court: No.

A. Well, he wanted to know why we had proceeded in the state court rather than the federal court in a matter like this, and we discussed that and just went over the ground, that the ones who thought we were familiar with this before the proceeding was filed had covered, and we referred him to the state statutes, and we discussed the advantages and disadvantages of state courts as against the proceeding under Chapter 10 of the Chandler Act; and he talked about [fol. 3605] the people he represented.

Q. The people he represented?

A. That is right, the group he represented in Fort Wayne, and wondered if we could work together on this and wondered if I was wedded to Messick or Pulfer and asked what I thought about them and about their ability and so—a general discussion along constructive lines.

The Court:

Q. During that discussion, Mr. Koontz, was it the thought of both you and Mr. Fleming that the proper thing to do was to reorganize Fidelity in some way, whether in state court or a federal court?

A. That is true, yes, sir, reorganize it by rehabilitating it with some capital. That is right. But it had already been changed into an insurance company. He talked more insur-

ance than he did these investment contracts, and he asked me specifically whether or not I thought the assets ought to be sold to a life insurance company, disposed of, closed up, or whether or not it could be reorganized, and talked about how to reorganize it, if we did, what people to take care of.

Mr. Farmer:

Q. What do you mean "what people to take care of"?
[fol. 3606] A. I meant the contract holders, the preferred stockholders, the common stockholders.

Q. Well, I hope you gentlemen at that conference didn't forget the contract holders.

A. The contract holders were first. And we agreed that if there was any way of giving present contract holders, although it looked as if there was no equity for them whatever, the right to buy in later on by way of rehabilitation, it should be done.

Q. You don't mean that there was no equity for the contract holders?

A. I mean the stockholders; I beg your pardon. Then he left that conference asking me if I couldn't draw a plan of reorganization and get it to him by the following Monday. That was about Thursday. I remember I said to him, "I don't think I am that good; I don't know enough about reorganizations for that. It is too soon." He said, "Get me something if you can, because I want to talk it over with my associates and I want to tell them that there is some chance, we think, of rehabilitating the company."

Q. Did he say who his associates were?
[fol. 3607] A. Yes, I questioned him about his associates. Frankly, I thought he might represent the Lincoln Life Insurance Company, with whom we had been dealing. He said definitely he did not, but he did represent the same interests in Fort Wayne, being the Lincoln National Bank people, and had them as associates—the same people that did control the Lincoln National Life Insurance Company.

Q. They are in South Bend, Indiana, and Mr. Fleming was from South Bend?

A. No, Fort Wayne. I didn't get a plan to send to him like he had asked, of course. I was at Cincinnati the first of the next week, and I tried to get him on the telephone,

but missed there, but got him a little later and we discussed it again by telephone.

Q. Did Mr. John Marshall talk to you about any plans that Mr. Fleming and Mr. Messick had?

A. John Marshall later on *later on* talked to me about Fleming, and he believed that Fleming had some people that would go into this, and Mr. Fleming had said to him that he thought it ought to be in federal court, but that was considerably later.

[fol. 3608] Q. Up to the time that Mr. Fleming first came on the scene in the way that you have outlined, had anyone connected with the company as attorney or director or as officials—public officials—taken the position that the proceedings ought to be in federal or bankruptcy court and not in the state court?

A. No, nobody ever took that definite position.

Q. In your conferences with the Securities and Exchange Commission had they taken that position?

A. No, no, they had not. They said, "That is a matter for you gentlemen to decide, what your jurisdiction is. We won't advise you on it." I talked that over with Mr. Carver a number of times, and he said, "No, we refuse to advise you the forum you are going to choose." I think it is only fair to say that our state proceeding had been filed. I did see Mr. Schencker a number of times. I used to see him at lunchtime at the Carlton Hotel; and he said, "Well, my thought was this"—

Mr. T. C. Townsend:

Q. Who was that?

A. Mr. Schencker, who is head of one of the departments of the department.

[fol. 3609] Mr. Jaegerman: He is no longer associated with the Securities and Exchange Commission.

The Witness: I know, but what department was it?

Mr. Jaegerman: Investment companies.

The Witness: But that was the most definite thing any SEC man ever said to me. He said, "My thought was that you would have fared better probably under Chapter 10." That was after this other was over. He was interested, and would ask me how we were getting along. I saw him from week to week for several weeks.

Mr. Farmer:

Q. After that Detroit proceedings had the Securities and Exchange Commission kept in very close contact with the Fidelity company?

A. Had the SEC kept in close contact?

Q. Close contact with the company.

A. I feel that they had kept rather in close contact. They went through the various proceedings, the circuit court of appeals, the appeals from the receivership proceedings in the Northern District here, and I had myself advised from time to time how I thought they were getting along, and had during last year sometime gone over there and talked to [fol. 3610] them about the policy of what we thought then might be done of getting these contract holders where the contracts were so much under water to revise their contracts and cancel out a lot of their claims. One series, for instance, we had only about a thousand contract holders and thought then that they could contact them and get them to revise their contract. I talked that over with them.

Q. You say revise their contracts—

A. I say they talked that. That was one plan we talked about putting into effect.

Q. After the Detroit proceeding did Mr. Jackson and other accountants or auditors stay down at Wheeling for some time? Do you know whether or not that is true?

A. Well, for two or three months I would say it was. But I don't think it was all on Fidelity. I think they were in that district on other matters, and were keeping in touch with Fidelity. I gathered that from conversations, that they would keep in touch with a case for some time after it looked like it was over.

Q. In your experience in handling reorganization matters and in the study that you have made of it and the contracts that you have had and talking over reorganization of this [fol. 3611] company and other companies with persons having experience, have you found out whether or not in a reorganization of a company of this kind, or insurance company, that the speed with which the reorganization is handled is essential?

A. It is at least very advantageous.

Q. That is, I am talking about what is the effect of pro-

tracted litigation on policy holders or contract holders as to whether or not they will keep up their payments?

A. Well, they usually don't keep them up, of course.

Q. State whether or not in taking over companies, re-insuring companies, it is an accepted fact among insurance circles that those policy holders that have ceased for some length of time to make payments and have dropped out, so to speak, are disregarded as being of any value as an asset?

A. I am not an insurance man. I don't know that I would be qualified on that, but I will say this, with all these people with whom I talked, these bankers, they regarded the live contracts as the real assets of the situation rather than the [fol. 3612] ones who had ceased paying. If that is an indirect answer to your question—

Mr. Farmer: Yes, sir, I believe that is all.

The Court: Before cross-examination of Mr. Koontz is started we will take a short recess, and reconvene at twenty minutes after three.

(At 3:06 P. M., a recess was taken until 3:20 P. M.)

After Recess

3:20 P. M.

Mr. Farmer: If your Honor please, I have one more question I want to ask the witness, the main question I subpoenaed him here about.

The Court: I don't want to prevent you from asking the main question, so go ahead.

Mr. Farmer:

Q. That is this, Mr. Koontz: Mr. A. L. King testified that he got the impression from talking with you and Mr. Foulk casually that the company would perhaps have to go through the federal court with your plan—go to the federal court with your plan worked out as far as you could get it in the other court or with the state department. In other words, he said his impression from talking with you and Mr. Foulk was that eventually you would have to go into the federal court. Did you advise Mr. King to that effect or [fol. 3613] make such statement to him?

A. No, I did not. The only discussion about that that I remember was a general discussion that after this proceeding was filed here we would probably have proceedings in various places both in state courts and federal courts

over the country; that there would probably be a lot of suits, like there was before when there was a suit in Michigan and then receivership in the Northern District of West Virginia and various suits over the country. We talked about various suits being filed, but never the main proceeding in another court.

Q. In your negotiations with these different men and houses and financiers and bankers throughout the country, as you have detailed throughout the years 1939 and 1940, did you endeavor at all times to give them the true and Fidelity?

A. Oh, yes, insofar as I was able to I gave it to them, and then invited them to take the audited reports; and the ones of them who got down and worked on it seriously sent their men to the head office at Wheeling and made audits of their own and checked audits that they had and [fol. 3614] so on. I attempted in no way to conceal any facts, and if I had I couldn't, because they were all business houses and made their own audits really, most of them.

Q. State whether or not the principal officers of the company are men that have been with the company over quite a period of years, a number of years, and have more or less grown up with Fidelity?

A. Mr. Risley, who has been president until lately, is probably one of the oldest members, yes. He has been there, I think, probably twenty or twenty-five years.

Q. Longer than Mr. Messick?

A. Yes, Mr. Messick has been there only since last year sometime.

Q. These other men, the officers or heads of departments, they, of course, feel a great disappointment in the fact that Fidelity had to fail, do they not?

A. They certainly do.

Q. And they have hoped—have always expressed hope that in some way there could be some reorganization of the company?

[fol. 3615] A. Yes, sir.

Q. Is that sort of their attitude?

A. Yes, sir.

Mr. Farmer: That is all.

The Court: Who wants to cross-examine Mr. Koontz?

Mr. T. C. Townsend: Your Honor, I would like to ask a few questions.

The Court: All right; go ahead.

Mr. Lauritzen: If the Court please, before Mr. Townsend starts his cross-examination, this morning it was suggested that the State of Wisconsin had no interest in Mr. Townsend's matters in this Court relating to the administrative conduct of this estate. I wish to renew my objection to Mr. Townsend conducting a cross-examination on this issue.

The Court: Overruled.

Mr. T. C. Townsend: I think my position will be clear before I get through. At least, I hope so.

Cross-examination.

By Mr. T. C. Townsend:

Q. Mr. Koontz, how long were you connected with Fidelity?

[fol. 3616] A. I think it was in 1932 and went out as a director in the early part of 1940.

Q. Do you know what time in 1940?

A. Not later than the middle of the year, probably a little earlier. As I remember, I resigned and they asked me to permit them not to accept the resignation for a few weeks. That is merely from memory. I think the minutes should show that. I have never seen them.

Q. How did you happen to become connected with Fidelity at all?

A. As I stated on the main examination, I did this piece of work for them, and I was asked by Scandrett and Marshall to become associated with them, and I refused the request, and a little later they made me a director and renewed the request, and I became connected with them; by invitation I became connected with them.

Q. Then you were a director from the time you became connected with Fidelity until 1940?

A. That is right.

Q. How many shares of stock did you own at any one time in Fidelity?

A. One was assigned to me as a qualifying share; that [fol. 3617] is all.

Q. And you never owned to exceed one?

A. Never owned—never paid for that; that was assigned to me. It was a qualifying share only.

Q. As a matter of fact, you were a director of the company from April 15, 1932, to June 30, 1940? Is that correct?

A. I accept your dates, yes, sir. I don't know that it is incorrect.

Q. And you were a vice-president of the company from April 28, 1933 to April 27, 1934.

A. I don't think I was, sir. They elected me vice-president once, and I refused to accept it.

Q. Well, you mean, then, that you did not actively serve?

A. That is right, yes, sir. I didn't know that it was—I was asked to serve as vice-president and said no—I didn't know if I—

Q. You were placed on the investment committee on September 18, 1934, and served till June 18, 1940? Is that correct?

A. I accept your dates. I don't remember.

[fol. 3618] Q. And you served on the executive committee during the years 1932, 1933, 1934, 1935, 1936, 1937, 1938 and 1939?

A. I accept the dates, yes, sir.

Q. And you were selected special attorney, that is, your firm of Koontz, Hurlbutt & Revercomb, in 1933, and you served during that year and for 1934, 1935, 1936 and 1937?

A. All right.

Q. And then the firm name appears as Koontz & Hurlbutt and you served with that firm in that capacity for the company for 1938? Is that right?

A. That is right.

Q. And then Koontz & Koontz served as special attorneys for the company for 1939, 1940 and 1941?

A. That is right.

Q. Up until the time it went into the hands of the receivers?

A. Yes.

Q. Did you ever resign as special counsel at any time?

A. No.

[fol. 3619] Q. Then your relationship as special counsel was terminated by action of the court in 1941, that is, the state court receivership?

A. Yes.

Q. If it was terminated at all.

A. If it is terminated—

*Q. It may still be going on. I don't know.

A. Well, the compensation is not going on, so I assume our relationship is not going on.

Q. If you owned no stock in the company or your stock was limited to one share during those ten years, what was your real interest in the company?

A. My real interest in the company was upon request of these gentlemen to help them build the company up, rehabilitate the portfolio—

Q. Was it in bad shape when you went with it in 1932?

A. Yes, sir, it was.

Q. And it was your special interest, then, after you went with the company to rehabilitate it and build it up?

A. Was to help rehabilitate it and build it up, yes, sir. [fol. 3620] At the same time, I was getting a monthly stipend, as I remember, Mr. Townsend.

Q. I was just going to ask you something about that. I wondered if you were.

(Witness laughs.)

Q. I am going to ask you this particular question, and you can break it down, if you please, if you can't answer it as a whole. What was the total compensation you received from Fidelity during the time you were connected with it from 1932 to 1941?

Mr. Palmer: If your Honor please, I fail to see the relevancy of anything in connection with the trustee to this hearing in that matter, and therefore I object to it.

The Court: Overruled.

Mr. T. C. Townsend: I think the relevancy will appear, your Honor, otherwise I would not ask these questions.

The Court: I overruled the objection.

Mr. T. C. Townsend: Go ahead and answer.

A. I don't know exactly what it was. I have understood that some figures have been submitted here that lead into [fol. 3621] eighty-some thousand dollars. I have no reason to feel that those figures are not correct.

Mr. T. C. Townsend:

Q. That \$80,000 didn't cover this ten year period. I am asking you for the total compensation you received for the ten year period, if you know?

A. I do not know, sir. I did not receive any very substantial fees; I received \$200 per month; no large fees of any kind up until the SEC proceeding.

Q. Now, Mr. Koontz, in what litigation was the company engaged while you were its attorney, special or otherwise?

A. Very little; a few cases here. People would sue the company on contracts trying to get back their payments with interest; and we went to Ohio at one time to meet with the Commissioner, and I think probably two trips two of us were over there—just advised generally. I don't know—there were not very many suits.

Q. Well, you did have some litigation pending in the courts in the several states, did you not?

A. Not that we handled, sir; or were responsible for.

Q. I don't know who was responsible for it, but you had [fol. 3622] to have—you did have litigation that you were called upon to take a part in.

A. You mean Fidelity as a company?

Q. When I say "you" I mean Fidelity, unless I say otherwise, or I can use the term Fidelity.

A. I don't—I don't remember that we had any very important litigation between the time I went on as a director and the SEC litigation.

Q. My question would include the SEC litigation. You did have the litigation in Michigan in 1938.

A. Oh; yes, that is true, getting up into 1938, yes.

Q. And you had litigation in the Northern District of West Virginia?

A. That is true.

Q. When was that?

A. That was in the early part of 1939.

Q. And that litigation was conducted in the District Court for the Northern District of West Virginia, and ultimately in the Circuit Court of Appeals for the Fourth Circuit?

A. That is true.

Q. And the litigation in Michigan ended in the District [fol. 3623] Court for the Eastern District of Michigan?

A. That is true.

Q. Do you recall any other suits that Fidelity had in the courts of any magnitude that you were called upon either to defend or prosecute?

A. Well, in connection with this—or at the same time that this receivership proceeding was filed in the Northern District of West Virginia, various proceedings were filed elsewhere. For instance, there was a proceeding in Pennsylvania, there was a proceeding in Indiana. Some suit of some kind against the directors over in Cleveland.

Q. All right, let's take the suits in the Northern District of West Virginia. What particular part did you take in that, in conducting that litigation in the Northern District? Any?

A. I was there day and night except for one or two days, that I went to Detroit.

Q. I mean, what did you do in that litigation?

A. Well, my firm was responsible—largely responsible for that. Goldsmith did the arguing before the Court. [fol. 3624] Local counsel were, in addition to Mr. Foulk, Mr. Wood.

Q. Did you do any yourself?

A. Very, very little.

Q. You didn't appear in court in connection with it—

A. Oh, yes.

Q. You appeared in court, but you took no part in the court proceedings? That is what I mean.

A. You mean in arguing the case?

Q. You didn't argue it?

A. I didn't argue the case, no, sir.

Mr. Palmer: If your Honor please, I am going to renew my objection. Mr. Townsend has not yet disclosed any relevancy of the questions to the present proceedings and whether they are brought in good faith or not. I think even Mr. Townsend, representing the trustee, should be limited in his examination to the scope of these issues.

The Court: I have indicated that my view is that the connection of Mr. Koontz or his firm is relevant on the issue which may arise under sub-section 4 of Section 146—

Mr. T. C. Townsend: Your Honor, that is the reason for my taking part in this examination. If your Honor thinks [fol. 3625] these questions are not relevant to that particu-

lar question, or won't lead to that particular question, I am entirely willing to abandon them.

The Court: It seems to me that they are relevant.

Mr. T. C. Townsend: That is what I thought.

Mr. Palmer: Your Honor, may I ask what right the trustee and its counsel, who are supposedly disinterested parties have to attempt to uphold the good faith of the debtor in filing the petition? That would immediately disqualify the trustee and its counsel from being disinterested. The statute requires the trustee and its counsel to be disinterested on the question of whether the debtor's petition is filed in good faith, and if counsel for the trustee or the trustee becomes interested in it, they immediately become interested and should be disqualified by the Court.

The Court: I have overruled the objection.

Mr. T. C. Townsend:

Q. Did you argue it in the Circuit Court of Appeals?

A. No.

Q. You did not go down there?

A. No.

[fol. 3626] Q. You did not prepare a brief?

A. No.

Q. You did not prepare a brief in the state court?

A. My firm did.

Q. I am trying to find out what you did.

A. Well, I—(witness laughs.)

Q. Not your firm; I want to know what service you rendered.

A. Well—

Q. The only services rendered in the litigation in the Northern District of West Virginia and the Circuit Court of Appeals in connection with that case were rendered by your firm, and not yourself individually? Is that a correct statement or not?

A. No, sir, it is not, because I took part in conference day and night with the District Court—

Q. Then I will put it this way: the services you did render in that litigation was in the way of conferences among counsel?

A. That is right.

Q. Does that same thing apply to the litigation in Michi-

gan? If so, you will save me from asking a number questions. [fol. 3627]

(No answer.)

Q. That is, the only way you took part in the litigation in Michigan was by conferring with other counsel that were conducting the litigation for Fidelity? Is that right?

A. No, the Michigan situation was handled primarily in Washington in the SEC offices, where we did confer, and got an agreed order or judgment before we went to Michigan. Then we had a local representative that appeared in Court in Michigan on one side, and Mr. Jaegerman and Mr. Lane on the other side, the day that order was entered.

Q. And the only appearance in that court was for the purpose of entering that final order, by anybody.

A. That is true at that time. Later on, when some literature was sent out that the SEC criticized, I went to Michigan and met Mr. Lane there, and we appeared before the court in chambers relative to that, the propriety of sending out a pamphlet, and a discussion of what could properly be sent out.

Q. You stated in your examination in chief that you spent [fol. 3628] a good deal of effort and time in trying to interest financiers in furnishing money to rehabilitate Fidelity. That is correct, is it?

A. That is correct.

Q. When did you first decide, in your own mind, or by reason of conferences with others, that Fidelity was in need of rehabilitation?

A. We were convinced by the SEC proceeding that we could proceed much more smoothly with a buildup of our general structure.

Q. What situation presented itself to you when you first became connected with the company in 1932? What was its condition then?

A. The condition then was that it was under water quite a bit.

The Court: You mean it was insolvent?

A. I meant—I think on an overall basis it was insolvent. They were selling then this B contract, which they provided a special deposit back of, so that the actual contract they were selling was not insolvent, but on an overall basis I

think it was insolvent, that is, adding all of the obligations together and all of the assets of the company together. [fol. 3629] On a market basis it certainly was.

Q. Did it ever get out of that condition?

A. I think so. It was supposed to be out of that about 1936 or 1937. It was 1937, I believe, they claimed to have made a very substantial amount of money.

Q. Then when did you find out it had got back in, if you did find out?

A. Well, these gentlemen from the SEC analyzed this whole situation and claimed that we must make representations to the public on the exact standing of all these contracts outstanding, rather than make an overall statement and add all assets and all liabilities together. No matter if you appeared solvent by that kind of statement you still were not justified in doing business with that sort of statement; and when you broke your statement down into the contracts and what was back of those contracts some of them showed in red. So they felt they needed capital at that time—was to get enough capital in your common stock account to show that you had enough to meet your payments on all of your contracts.

Mr. T. C. Townsend: Let me see if I understand you. [fol. 3630] Do I understand you to say that when you went with the company in 1932 in your opinion it was insolvent?

A. On a market basis it probably was, yes—on a market quotation basis.

Q. You mean if you valued the securities—

A. At their quotation on the market.

Q. Quoted market value.

A. That is right. Of course, the statement of the company did not show it was insolvent by any means. They left the securities on the books at appraised value, purchase value or whatnot. The statement did not show insolvency.

Q. If it was insolvent in 1932, when you first became connected with it as a member of the board of directors, what did you do about it?

A. We attempted to make money and to keep on running until your market quotations went on back up, like all other institutions.

Q. Did you feel at that time that you needed any new capital?

A. We certainly felt we would like to get new capital.

Q. Did you make an investigation of Fidelity after you [fol. 3631] became connected with it to find out some of the reasons why it was insolvent?

A. No, I gradually learned some facts about it, that they had sold securities on the way down, as the market went down, and they kept getting harder up and harder up and were not able to replace those securities in the portfolio.

Q. Is that the only thing you learned with reference to its condition, that it sold stocks on a declining market?

A. Well, stocks and bonds. I learned it had some very substantial losses, too, on some post office bonds—I think that was the biggest loss it had—something that had been purchased some few years before.

Q. Well then, it was your opinion after you made an investigation that when you became connected with the company its condition was due very largely, if not altogether, to the fact that it had sold securities on a declining market? Is that true?

Mr. Palmer: Your Honor, I object to the use of the words "after he made an investigation." The witness has not said he made an investigation. He said he learned [fol. 3632] things slowly. He never investigated.

The Court: I think that is correct. The question may be revised to conform.

Mr. T. C. Townsend: I didn't get the Court's ruling.

The Court: Mr. Palmer is correct. The witness didn't say he made an investigation when he came in.

Mr. T. C. Townsend:

Q. When you became connected with the company in 1932, did you ever make an investigation to determine what its financial condition was?

A. No, I merely looked at the statement furnished.

Q. What sort of statement?

A. They had, as I remember, Ernst & Ernst for the auditors at that time. They would have a statement at the end of each year. A little later on one of the nationally known auditing firms audited the company for

a year or two; and I just accepted those statements at face value.

Q. That is the only investigation you made?

A. That is true.

Q. How did you find out about these falling securities?

A. That comes out from time to time in discussion or [fol. 3633] directors' meetings.

Q. That was an investigation, wasn't it, to that extent?

A. Well—

Q. If it wasn't an investigation, it was knowledge.

A. I was gradually getting knowledge, yes, sir.

Q. Then you began to get knowledge by reason of these falling securities that the company was in bad condition?

A. Based on a market value, yes.

Q. And after you received this knowledge, your opinion was and your conclusion was that it was in bad condition because of the falling market? Is that correct?

A. That is correct. Market-wise it was in bad condition, yes, sir.

Q. And no other reason. You attributed to that falling market bringing about of the financial situation with reference to Fidelity? Is that right?

A. I think that was the main item. There may have been some mismanagement in prior years. I don't know about that.

Q. Did you investigate to find out?

[fol. 3634] A. We tried to build up management. Got a man by the name of Pole, who was comptroller of the company, go in as president. At all directors' meetings we were talking about what we should do to become stronger, both in management and assets.

Q. I understood you to say you learned that there had been some prior mismanagement.

A. No, I said there might have been.

Q. Well, was there, prior to the time you became connected with it?

A. There may have been?

Q. Well, was there?

(Witness laughs.)

Q. You can answer that, Mr. Koontz.

Mr. Palmer: If your Honor please, if the trustee is finding that out for the purpose of its 167 report, the books of the company are open to it and it can investigate it.

just as easily as Mr. Koontz could. If they are asking it for any other purpose it is an improper question.

The Court: Overruled.

• Mr. T. C. Townsend: Answer the question, if you can.

[fol. 3635] A. Well, according to my ideas there had been some loose management.

Q. Well, all right; what was it?

A. For instance, the sales agency.

Q. Well, that was what?

A. I thought had been spending too much money; were in debt to the company.

• Q. Anything else besides the sales agency?

A. That was—stuck out like a sore thumb. I am not so sure about—

Q. Well, were there any fingers sore next to the thumb that you discovered?

A. I do not—

Q. Or that stuck out—

The Court: Mr. Townsend, if you would let this witness answer instead of interrupting him—

Mr. T. C. Townsend: Your Honor, I did not mean to do that. He had not started to answer.

A. When I first knew about the company they had a part time president of the company, Mr. Burt, who was on for a very nominal salary as a part time president. The company was really being run by a vice-president. [fels. 3636-3641] That didn't look like good management. Later on that was changed, as I say, by taking Mr. Pole as president and asking to get in anybody he wanted to build up his management, and he is the one that first brought in his securities man to keep tab on the portfolio.

[fol. 3642] Mr. Palmer: During the cross-examination of Mr. Marshall last Saturday morning I attempted to ask him the same or similar questions along the same lines, and the Court ruled at that time that the Court was not interested in whether the company had been mismanaged because he would not have anyone that had had anything to do with the mismanagement have anything to do with the company in the future, and therefore the questions were irrelevant. I am suggesting that to the Court because I

believe these questions are along the same line as those I asked Mr. Marshall which were excluded upon objection of the trustee and debtor.

The Court: I thought I clearly explained my reason for admitting evidence of Mr. Koontz's connection with Fidelity, but I will restate it. Under Section 146, sub-paragraph 4, one of the questions to be decided in determining whether a petition is filed in good faith is whether there is a prior proceeding pending in any court and it appears that the interests of creditors and stockholders would be best sub-[fol. 3643] served in such prior proceeding. Now, there is a proceeding pending in the Circuit Court of Kanawha County, West Virginia, and Mr. Ross Thomas, of the firm of Koontz & Koontz, has been appointed one of the receivers; and I am of opinion that any evidence of the connection of Mr. Koontz or Mr. Thomas or any member of the firm or associate of the firm of Koontz & Koontz with the affairs of Fidelity prior to that appointment of those receivers is of some pertinency in determining that question, and therefore I have ruled that that testimony is admissible, and I adhere to that ruling. Of course, a different situation was presented when the questions were asked of Mr. Marshall's connection.

Mr. Palmer: If your Honor please, may I ask the Court to clear this up, which I think you did yesterday. The questions were not as to the ability of Mr. Thomas, but as to his suitability, I believe the Court said?

The Court: That is correct, yes.

Mr. Palmer: I have this thought in mind, your Honor, that the suitability would be dependent upon the question of whether or not there was a possibility of any wrong-[fol. 3644] fulness going on, that that would be entirely under the judge of that court as to the compensation and guidance and so forth of that receiver.

The Court: Well, I don't so perceive it. I think the decision under Section 146 is entirely the responsibility of this Court and not of another court; and although some other court may feel that a prior proceeding that is now pending would be for the best interests of creditors and stockholders, this Court must examine into that and determine for itself whether that is a fact or not a fact.

Mr. Palmer: I agree with your Honor on that, but the point in mind that I couldn't see was this, that in state

court proceedings there is no law or intimation of any law that a person representing a debtor who goes into receivership cannot be one of the receivers. In fact, as this Court knows, that is a very common practice. In federal court there is a direct law against that. Now, the only way that I can see the relevancy of that is that the Court would be attempting to apply the federal rule to the state court.

The Court: I am not applying any rules to the state [fols. 3645-3664] court.

Mr. Palmer: May I have an exception to the Court's ruling? Perhaps I did not make an objection at the time I was asking the questions.

[fol. 3665] The Court: Let's see if we can get at the thing that the Court thinks is the only material phase of this in this way. In setting up an appraised valuation for the trust certificates of Marston Company and Paull Company, was the obligation of National Sales Agency treated as having any value, and if so, what percentage of its face value?

Mr. T. C. Townsend: That is a question to the witness, I understand.

[fol. 3666] The Court: That is right.

A. I don't know what percentage, your Honor. I remember this, that when the sales organization was taken over, various statements were made as to the cost of building up a sales agency and that we were getting this for nothing; if we had a million dollars just to pay over to the National Sales and they would pay it back it would clear in that way and wash out, but we didn't have the million dollars to pay, and it was handled the other way. We were told that there was actual value back of the sales force that was taken over. Thereafter interest was paid on this note and some reductions made from time to time.

The Court:

Q. Well, was it given any value, if you know, in the appraisal of the Marston and Paull Company securities?

A. I think it was given some value, yes, sir. I remember it was questionable what the value was; there was quite a large insurance policy that was collateral on that note, and the company carried that for some time. That had a cash value.

Q. How much, if you know?

[fol. 3667] A. I don't know. That is in the record somewhere.

Q. What other assets, if any, were behind it to give it a value other than this consideration that Mr. Palmer spoke about?

A. Only the value of the building up of the organization—the sales organization.

Q. That would not enter into any appraisal of the worth of it in the hands of Marston Company and Paull Company, would it, as securities of those companies?

A. Well, you were in this position, having taken that over, it was built up at quite a cost. You could have foreclosed and taken it over and not given it any value, or you could keep your books the other way.

Q. I am not speaking now of its value in the hands of Fidelity, but I mean do you know of any way that that would add to its value as a security in the hands of some state depository securing contract holders?

A. It would be hard to appraise that as a value of \$750,000, although over a period of years it might be paid off with interest, if I may answer it in that way; because that is exactly the way it was handled; it was reduced so much each year, interest paid on the note and it was to be reduced [fol. 3668] from time to time. Of course, it is valueless if you are not a going concern and can't use the asset that was taken over.

The Court: Are there any other questions, Mr. Townsend?

Mr. T. C. Townsend: Not on that point. If Mr. Jaegerman wants to ask a question on it, I think now is the time to do it.

The Court: All right, Mr. Jaegerman.

Cross-examination.

By Mr. Jaegerman:

Q. Isn't it true, Mr. Koontz, that these National Sales Agency notes amounting to a million dollars resulted from advances by Fidelity to National Sales Agency?

A. Isn't it true that this amount represented by the note resulted from advances?

Q. Yes.

A. I understand so.

Q. And these advances came from the Fidelity general fund? Isn't that so?

A. They were supposed to, yes, sir. As far as I know [fols. 3669] they did.

Q. But the general fund, not having enough money, sold or transferred these notes to two of the contract funds, the income fund and the annuity fund? Isn't that right?

A. I don't know. I don't say it is not right. I just don't remember the answer.

Q. So that a condition resulted where the National Sales note, if it were an asset, was an asset held by two contract funds? Isn't that right?

A. Well, it may have been. I am saying I don't remember what those transactions were.

Q. And as National Sales Agency notes they were not depositable with any state against contract liability for the income or annuity contract? Isn't that right?

A. Well, I don't know. I don't think they would qualify as deposits, if that is what you mean. Is that what you mean?

Q. Yes. When they were converted into Paull and Marston bonds, the bonds, in turn, were transferred to the contract funds, the income and annuity funds, were they not? [fol. 3670]

A. Well, I assume they were.

Q. And isn't it true that the only state that would accept them for deposit was the State of West Virginia?

A. I don't know. I understood West Virginia accepted most of them. I don't know.

Q. Did any other state accept them?

A. I don't know whether they were accepted anywhere else or not.

Q. Isn't it true that for deposit—

A. I don't know whether they were tried anywhere else or not.

Q. Do you know that they were tried anywhere else?

A. No, I say I don't know that they were tried.

Q. Are you familiar with the Craigin Morris valuation?

A. Generally, yes.

Q. What were those Craigin Morris valuations?

A. Craigin was a real estate man from Cleveland who had worked for the Insurance Department of the State of Ohio, and he was recommended to Colonel Thompson, who was from Ohio, as a man who knew real estate valuations,

and he put him on these real estate holdings of this company and asked him to evaluate them.

[fol. 3671] Q. And the deposited value of the Paull and Marston bonds was determined on the basis of the Craigin Morris valuation, was it not?

A. I think so, where they were available. If not, some other yardstick was used.

Q. And didn't the Craigin Morris valuation accept at full face value the notes of the National Sales Agency?

A. I don't remember about that, Mr. Jaegerman. I am not evading; I just don't remember whether they accepted that note at full face value or not. As I remember, they did. As I remember, that note was in there at full face value and was reduced from time to time.

Q. And on the basis of the statements by certain officers and directors of Fidelity to Craigin Morris that the interest was paid on these notes, Craigin Morris accepted the notes of the National Sales Agency at the full face value?

A. That is true.

Mr. Jaegerman: That is all on this point, your Honor.

The Court: All right.

[fol. 3672] Cross-examination (Resumed).

By Mr. T. C. Townsend:

Q. Mr. Koontz, at the time you went on the board of directors of Fidelity, did you find anything with reference to what has been referred to here as interfund loans?

A. Not for some time. If I did, it didn't impress me as to what it was.

Q. Well, did you finally find out?

A. Yes, I finally found out.

Q. How long had you been on the board?

A. I don't remember, sir.

Q. What were those interfund loans?

A. Well, when one fund would be in excellent shape and another fund would need some advances, there would be an interfund loan to take care of the one that needed the advances.

Q. Take it from the good fund and transfer it to the bad one?

A. That is right.

Q. And authority for doing that under the contracts that you sold?

[fol. 3673] Mr. Palmer: Objection, your Honor.

The Court: That is a legal conclusion. I sustain the objection.

Mr. T. C. Townsend:

Q. When these various series contracts were sold, did you set up separate funds for each one of them?

A. I didn't come on until after most of these contracts had been sold. The B contract was the one I was familiar with. It says specifically that there should be a contract fund set up and maintained for that. There was always a question and some argument about whether separate contracts should be kept for the other.

Q. The books of the company did show that a separate fund had been set up for each contract?

A. I think they kept the books on that basis.

Q. But in practice, so far as the funds were concerned, they were not carried out according to the bookkeeping system? Is that correct?

A. I think that is correct, yes, sir.

Q. In other words, you didn't keep these funds separated as a matter of fact?

A. They were deposited, as I remember—the securities [fol. 3674] were deposited all in one vault, or one box in the vault, instead of being kept separated, although they were kept on the company's books separate and distinct.

Q. Did you think it was a good practice to take the funds—take the money from a solvent fund and lend it to a fund that was insolvent?

Mr. Palmer: Objection.

The Court: Sustained.

Mr. T. C. Townsend:

Q. Well, was that done? Did Fidelity use the money from solvent funds and lend it to insolvent funds?

A. I don't know about funds being insolvent at the time, and those interfund transfers, Mr. Townsend, they did transfer from one fund to another—had some interfund loans.

Q. Well, why did they do that?

A. I don't know all the reasons, but I know one reason was if one fund needed some money at a particular time and did not want to cash in some of its own securities or might have been short on securities at the time, the other fund would lend it some money. Remember, your common [fol. 3675] fund was back of and was a cushion for all these funds. If that were in shape to take care of it, the transaction would have been a cleaner transaction if the transfer had been made from the common fund into these funds rather than one fund to another, but so long as that fund was enough to take care of any advance or transfer I think your transaction was all right.

Q. How long was this system of interfund loans carried on? Until December 3, 1938, wasn't it?

A. Yes, sir.

Q. And then it was stopped.

A. By the SEC. That was part of the injunction.

Q. I am going to pass that over and ask you something else. I want to get through if I can. Mr. Koontz, when did it first occur to you—I am talking to you now, not to Fidelity—when did it first occur to you as attorney for Fidelity or in the capacity of a member of the board that it was necessary to have some sort of court proceedings to continue Fidelity in any capacity?

A. Well, Mr. Sims made some very strong suggestions very early in this year.

Q. He wrote you a letter—

[fol. 3676] A. Wrote me the letter in March, but he had made suggestions even before that, by telephone and face to face.

Q. Well, I am going to keep it as short as I can. You did confer with Sims?

A. Yes, sir.

Q. Was the situation discussed by the board?

A. Well, I wasn't a board member and wasn't at their meetings. It was discussed with the officers of the company from time to time.

Q. Was the situation of the company discussed with the attorneys of the company—special attorney—discussed with you?

A. The situation was discussed between Mr. Sims and me, yes, and I, in turn, discussed it with Mr. Foulk, who

is the general attorney inside the company, and with Mr. Marshall, who was chief counsel for the company.

Q. But you were special attorney?

A. Yes. I didn't know I was named as special attorney. I thought I was kind of local-attorney here.

Q. You were pretty active, weren't you?

A. Fairly so.

[fol. 3677] Did you discuss the matter with the SEC, the condition of Fidelity?

A. Yes, yes.

Q. Was that at the March 17th meeting?

A. Well, we did discuss that at that time.

Q. Well, did you discuss it at the March 17th meeting?

A. That is right; that is right, yes, sir.

Q. Was there any discussion at that time as to which court the proceedings should be begun in?

A. Yes, sir, questions were asked between and among us as to what forum should be chosen for this.

Q. What court did you prefer?

A. I had no preference. I had concluded, and so expressed myself—I am not sure whether it was at that meeting, but it was to Mr. Kline, and I think before that maybe, I preferred either the local court here, because of the statutes naming it, or the federal court in the Northern District, where the chief office of the company was located. Those were the two courts discussed most in connection with this.

Q. That was discussed at this meeting—

A. No, I am not sure that that was discussed in open [fol. 3678] meeting now.

Q. I am talking about this meeting of March 17th, when Mr. Jaegerman was present and other persons representing the SEC.

A. The general discussion then was limited, as I remember, as to whether it be state or federal; no particular court; just the two classes of courts.

Q. Did you express yourself at that meeting?

A. I don't believe I did. I am not sure.

Q. Did you have a preference when you were discussing it?

A. No, not at that time I didn't.

Q. That was the purpose of the meeting, was it not, to determine what sort of court proceedings should be instituted?

A. No, not necessarily. I think we discussed whether or not we might still go ahead and reorganize this company outside a court proceeding.

Q. But you concluded you couldn't do that?

A. No, No, Mr. Townsend, we did not. No, no, we discussed cutting down—

Q. I know you discussed that.

[fol. 3679] A. We discussed that, and my memory has been refreshed since I have been here and have another week to do some more work on it, to try to put our men out and ask the contract holders to cut down their claims on contracts and still go on through reorganization outside any court.

Q. In addition to discussing the question of reorganization, you did discuss the question of instituting court proceedings? That is true?

A. Yes, at some of these times very shortly unless something was done outside by way of reorganization it would be necessary.

Q. A general discussion of the advisability of going into court took place at your March 17th meeting? Isn't that true?

A. Well, we discussed court proceedings. I wouldn't say it was the main part of the discussion by any means.

Q. I didn't say it was the main part, but I said it was discussed at that meeting.

A. Well—

Q. Did you discuss particular courts, that is whether it [fol. 3680] should be in the state court or the federal court?

A. We discussed among ourselves whether it should be in state court or federal court.

Q. What do you mean by "among yourselves"?

A. The lawyers, on the side. Most of the discussion I remember was after the meeting broke up, and some of us, Mr. Jaegerman included, were standing over at the side discussing this.

Q. Was that a discussion with reference to what court the proceedings should be instituted in?

A. Well, some proceeding, yes.

Q. What was the result of that?

A. No conclusion reached on their part or our part either. Mr. Carver was there and some of Mr. Jaegerman's associates. My understanding was there was no definite con-

elusion on their part as to where proceedings should be filed, if it were filed, by the company.

Q. Did you express your preference at that meeting?

A. I don't think so.

Q. Did Mr. Jaegerman express his?

A. I am not sure that he did.

Q. Did anybody express their preference as to where [fol. 3681] the proceedings should be?

A. Somebody said this, that "I would think, with a general situation like this, it would demand federal procedure"—some expression of opinion like that.

Q. Do you remember who made that statement?

Mr. Palmer: Let him finish his answer.

Mr. T. C. Townsend: I thought he had finished.

A. Oh, no, I don't remember who it was. As I remember, I talked to Mr. Carver, of Mr. Schencker's department, more about this jurisdiction question than anybody else. He said, "No, we don't want to be put in position of advising you what your forum is to be; we don't know." We discussed both angles of this thing, and Mr. Kline expressed the same opinion.

Q. In your discussions with Mr. Carver and Mr. Kline, did you discuss the advantages or disadvantages of state and federal proceedings, respectively?

A. I discussed with Mr. Kline the terms of our statute and talked to him about a plan of reorganization, and he agreed that he would put me in touch with the reorganization division of the SEC and have them help work out something at any time I was ready to proceed, if we went [fol. 3682] that way. If we went the other way, they would come in automatically.

Q. What do you mean "the other way"?

A. If we went into a federal court. As I understand, it is automatic for you to come in, Mr. Jaegerman, if we are in a federal court; and they were to assist the other way, if we went the other way.

Q. After you had this discussion on March 17th and near that time, did you attend any meeting of the board of directors of the association?

A. No, I didn't.

Q. When was this state court proceedings decided upon?

A. This letter was addressed to me dated March 25, wasn't it? We had a number of conferences shortly there-

after. My advice was it was a separate proceeding in the state court, under our state statute. I talked to Mr. Partlow, as I said a while ago; I talked to my own associates, talked to Mr. Sims a number of times.

Q. Mr. Sims, in his letter to you of March 17th—or 25—says this in effect, “I should like to explore the possibility of placing this company in trusteeship under 77B.” “Inas-[fol. 3683] much as you have acted for this company in a legal capacity for several years, I wish you would consider the observations made herein.” Did you make any reply to Mr. Sims in reference to instituting a proceeding in federal court?

A. Under 77B?

Q. Of course, 77B was repealed at that time. Did you reply to that feature of his letter?

A. I did personally, yes, sir.

Q. What did you tell him?

A. After I made further investigation there I told him I thought the simplest procedure would be in the State of West Virginia.

Q. Why?

A. And the proper procedure.

Q. How did you reach that conclusion in preference to a federal court proceeding?

A. All right, sir. In the first place, the statute recites that he may proceed in the Circuit Court of Kanawha County. This was some of the reasoning, not only mine, but some other people I talked to in connection with this, Mr. Foulk, to be specific. In the old days the salesmen [fol. 3684] all recited and referred to these various statutes in West Virginia and what protection the people had and son on; so that we felt that these contracts were sold with these statutes as really a part of them, whether they were written into them or not, because they referred to them, and also that that statute probably meant something, and if it meant anything you would read into it a less expense to administer these assets by a state officer in a local court than if you did go in a federal court and get outside, away from your officer who was on a state payroll, than otherwise.

Q. You think, then, it would be more economical to administer this—

A. I certainly do, Mr. Townsend—I do.

Q. Just let me finish my question. You think it would

be more economical to administer this proceeding in a state court than in federal court?

A. In case of liquidation I certainly do.

Q. I am not talking about liquidation.

A. All right.

Q. Talk about anything you want to.

A. Then, going to the other side, about reorganizing, this was our reasoning on that, that no reorganization could be [fol. 3685] successful without the co-operation and assistance of our own Insurance Commissioner and some of the other insurance commissioners.

Q. You thought you could get them to—then it was a voluntary matter in the state court?

A. We would get those insurance commissioners sold on a plan and get before the state court and you would have a better chance to reorganize than anywhere else.

Q. And it would be entirely a voluntary matter in the other states outside West Virginia?

A. Yes, or you might have some ancillary proceedings in the other states, but we didn't see how you would have any chance to reorganize this—we talked about how we would get these securities in from the other states—if we could get them in—whether or not you could get a plan approved by the commissioners more quickly in a voluntary way than to bring them into court, and so on. That was talked of at considerable length.

Q. You didn't find any way to get them in, though, did you, the other states?

A. We didn't get to that, sir.

Q. Didn't you—

[fol. 3686] A. We never had a plan of organization.

Q. How?

A. We never got to a plan of reorganization to submit to the Court down here.

Q. You couldn't unless you got control of the assets, could you?

A. Well—

Q. And you did take steps to get in all the assets—

A. We did—

Q. (Continuing.) From the other states?

A. Down to our local court?

A. Yes.

A. I didn't so understand it. Our Insurance Commis-

sioner wired all the other people and asked them to act as receiver for the assets in their respective states.

Q. Didn't you send some representatives of your office to some of these other states to confer with them about coming into this state court proceedings here?

A. No, I did not.

Q. Didn't Mr. Goldsmith go out to Madison, Wisconsin, with reference to that question?

A. He went out with Mr. Messick on some hearing out [fols. 3687-3690] there. I don't know just what the scope of it was.

Q. And didn't you go out to see the Insurance Commissioner or insurance department with reference to bringing the assets into this court?

Mr. Palmer: I think there is no such testimony.

A. Not that I know of.

The Court: I will permit the cross-examination by the question. I agree with Mr. Palmer that there is no testimony to that effect.

[fol. 3691] The Court: That ought not to take much time.

There is one other observation I have to make in connection with the ruling that I made yesterday. Mr. Palmer [fol. 3692] made a motion to strike out certain opinion evidence which had been given by Mr. Burt, Mr. Pulfer, Mr. Risley, I think, and perhaps some others. There had been no objection made to this opinion evidence at the time it was received, and at the time Mr. Palmer objected to it yesterday I overruled his objection, and I am still of opinion to overrule the objection, but I want to make this observation in connection with it. The entire testimony of those gentlemen with reference to whom he made his motion is not fresh in the Court's mind. I am of opinion, from my recollection of it, that they qualified to give their opinion. However, if, on a more close perusal of their testimony I conclude that they did not qualify to give their opinions, then those opinions will not be given any weight whatsoever by the Court. I thought I should make that statement in view of my hasty ruling yesterday.

Mr. Palmer: If your Honor please, the reason I made that motion was this. We did not object to the opinion

being given, because, as I stated to the Court, we felt the Court would judge as to the weight which should be given it, having full advantage of their testimony and knowledge [fols. 3693-3694] edge. We felt, though, that Mr. Latta, the witness on the stand, had given his qualifications, and therefore was entitled to give an opinion, but if he were not entitled to then under the same basis the Court should not consider the other testimony, and it was only for that reason we made the motion.

[fol. 3695] Q. Mr. Koontz, after you received the letter of March 25 from Auditor Sims setting out his views with reference to Fidelity, did you make any written reply to that communication?

A. No, sir, I feel sure that I did not.

Q. Positive of it?

A. I think that is right.

Q. Did you reply to it at all?

A. Yes.

[fol. 3696] Q. In what way?

A. I conferred immediately with Mr. Partlow of the Attorney General's office.

Q. Well, did you confer with Mr. Sims?

A. Well, after that I conferred with him and talked to the various boys around my office and talked to Sims then shortly after that.

Q. You and Mr. Sims held a conference then, after the receipt of this letter?

A. Well, several conferences between the time that letter—

Q. March 25?

A. Yes, I conferred with him a number of times by phone and talked to him personally a number of times between that time and the time of filing the suit.

Q. Of course, in your conversations and conferences with Mr. Sims after the receipt of this letter, you notified and advised him fully with reference to the subject matter of the letter, did you not? Here is the letter, if you want to look at it. (Handing paper to witness.)

A. Thank you. Well, we talked—our conversations were [fol. 3697] on the main subject as to whether or not there should be a proceeding in the state court or the federal Court. That was the general basis of the discussion.

Q. And you advised him to proceed in the state courts rather than in the federal courts?

A. I advised him that I thought that that was the better place to proceed, yes, sir.

Q. Well, you expressed that to him as your best judgment?

A. I did.

Q. And as your legal opinion, that it was best.

A. I advised him definitely, Mr. Townsend, that he could proceed in the Kanawha Circuit Court or the federal district court of northern West Virginia. Those two courts were talked of; and then we talked about the advantages of one over the other and what was the proper one.

Q. I am not talking about a preference between the Northern District and the Southern District. I am just talking about your preference as between federal courts and state courts, and you advised him in favor of state courts?

[fol. 3698] A. I did. I thought it was proper for him to proceed in the state court rather than in the federal courts.

Q. After you had so advised him or between the time of the receipt of that letter and the institution of the suit, did you confer with the officials of Fidelity as their attorney?

A. I conferred a number of times with Mr. Tom Foulk, talked to him by phone, talked to Mr. John Marshall a number of times, yes, sir; I think with Mr. Risley; I am not sure. I talked to two lawyers, however.

Q. Did you give them your views as to a preference between the state and the federal courts?

A. I did; I expressed myself freely to them, as I had before.

Q. And you advised them to the same effect that you advised Sims?

A. Well, yes, sir, that was my conclusion. I let them have my conclusion.

Q. That you thought it was best for all concerned that the suit be instituted in the state courts?

A. That was my advice, yes, sir—to which they agreed, let me add.

[fol. 3699] Q. Then, through your rendering of your legal opinions after Sims had agreed to institute suit in the state court and officers of Fidelity had agreed that that

was the thing to do, you then proceeded to get ready the papers, or your firm did?

A. That is right.

Q. In conjunction with the Attorney General?

A. That is right.

Q. Is that correct?

A. That is true.

Q. And when the bill was filed in the Circuit Court of Kanawha County the Attorney General appeared there representing Sims?

A. That is right.

Q. And you, or your firm, appeared there representing Fidelity?

A. Well, I will say this. Mr. Sims asked—discussed fully after it was agreed that this proceeding should be filed, the question of handling it and so on. We did represent Fidelity in accepting service for Fidelity—represented them to that extent.

Q. Well, as a matter of fact, Mr. Koontz, on the 7th of [fol. 3700] April the board of directors of Fidelity passed a resolution and sent you a copy of it?

A. That is true. That is true.

Q. And pursuant to that resolution you did represent Fidelity in the state court?

A. That is right.

Q. And at the time the petition was presented you appeared there for Fidelity, the Attorney General's office appeared for Sims, and you entered a consent order?

A. That is right.

Q. With your full approval?

A. That is right.

Q. As attorney for Fidelity? Is that right?

A. They accepted service, Mr. Townsend. I wasn't present. There was no answer filed for Fidelity, remember.

Q. You assented to the order that was entered?

A. Made no protest to the order.

Q. You assented to it, didn't you?

A. Have it that way if you will, sir.

Q. The order so recites, doesn't it?

A. I don't remember the order, sir.

[fol. 3701] Q. At the time the bill was presented to the Circuit Court of Kanawha County, was there a representative of the Attorney General's office there at all?

A. Yes, sir, Mr. Partlow was there.

Q. And the order that was entered with your approval, to which you consented, appointed Mr. Ross B. Thomas as one of the receivers? That is correct?

A. That is true.

Q. And he is a member of your law firm?

A. Associate of my—

Q. And the other receiver was Mr. H. Isaiah Smith?

A. That is true.

Mr. Palmer: Mr. Townsend, was it an order or decree entered?

Mr. T. C. Townsend: Well, call it either one, I guess.

Mr. Palmer: Well, I just wondered. It was either one or the other.

Mr. T. C. Townsend: There was one order—I don't remember—appointing these receivers. I don't think there was but one entered at that time. That is the only one I am inquiring about.

[fol. 3702] Q. Now, Mr. Koontz, Section 146 of Chapter 10 of the Bankruptcy Act provides in effect this: "A petition shall be deemed not to be filed in good faith under paragraph 4 when a prior proceeding is pending in any court and it appears that the interests of creditors or stockholders would be best subserved in such prior proceeding." Now, at the time the petition was filed in his Honor's court and since that time and now, is it your reasoned opinion and judgment that the best interests of the creditors and stockholders could be subserved in the Circuit Court of Kanawha County rather than in a district court of the United States?

A. With due respect to this Court, it certainly is, Mr. Townsend.

Q. You maintain that opinion now?

A. I do for a fact, yes, sir.

The Court: Do you mean in this particular proceeding, Mr. Townsend, or in any proceeding?

Mr. T. C. Townsend: My question was broad enough to cover any proceedings, I think.

The Witness: I didn't so understand it. I understood it to be confined to this case, of course.

[fol. 3703] The Court:

Q. Do you mean in this present proceeding, with Mr. Thomas as one of the receivers?

Mr. T. C. Townsend: That is what I mean, yes, sir.

The Witness: He said "the petition".

Mr. T. C. Townsend:

Q. Now, Mr. Koontz, I want to ask you this question. Assuming there exists a possible or a probable liability on the part of the management of Fidelity to the contract holders because of bad management, and it was deemed necessary to institute suits to recover wasted funds, do you think that could best be done in a state or a federal court?

The Witness: Shall I answer that, your Honor?

The Court: If that question is amplified as to whether he thinks it can best be done as a part or as a result of a proceeding in a state or federal court—your question, as you asked him there, does not mean that, as I construe it.

Mr. T. C. Townsend: Well, I will amend it as your Honor suggests. Now answer it as amended.

A. It seems to me if the liability were established on the part of anybody you could sue them either from a state court proceeding or a federal court proceeding. In other [fol. 3704] words, that the receivers could sue them or the trustee could sue them.

Q. Well, in this particular proceedings where do you think you would get the best results?

A. I am not sure that there would be any difference. I think that your state receivers—

Q. Do you think the chances would be equal?

A. They certainly would within the State of West Virginia, and if you would get on the outside of the State of West Virginia your receivers could bring suits in another state against anybody who was guilty of mismanagement.

Q. Well, it is your opinion, then, that you could get as good results in the Circuit Court of Kanawha County as you could get in the District Court of the United States for the Southern District of West Virginia against any officer of the company who might be guilty of or connected with the wasting of funds of the debtor?

Mr. Palmer: If your Honor please, I will have to object to that. Mr. Koontz has said whether a suit was brought in the Circuit Court of Kanawha County or the District Court of the United States for the Southern District of [fol. 3705] West Virginia is a matter of no importance. I

think what your Honor has indicated as a result of the proceedings in any of those courts may be pertinent.

The Court: That is right: It doesn't make any difference to this Court, if the liability were attempted to be established, whether a suit was brought to enforce that liability in federal court or state court. That is not the point. And I don't think that is what counsel intends to address the question towards.

Mr. T. C. Townsend: Well, that is. Is that question objectionable?

The Court: Well, if you mean whether the company or the receivers of the trustee could better succeed in a suit brought in a state court or in a federal court against someone who is alleged to have been guilty of mismanagement, then I sustain the objection.

Mr. T. C. Townsend: Read the question.

(The question was read.)

Q. Let's put it this way. Is it your opinion that you could get as good results if you proceeded against an officer of the company or if it was found advisable to proceed against an officer of the company for wasting the debtor's funds, [fol. 3706] in the Circuit Court of Kanawha County or in the federal courts.

Mr. Palmer: Objection.

The Court: Sustained.

Mr. T. C. Townsend:

Q. Let me ask you this question. In the state courts or in the Circuit Court of Kanawha County, your firm represents Fidelity. Would you—and I mean you—feel free and unhampered in any attempt that might be made to recover funds due Fidelity from any party whom it was deemed advisable to proceed against in the Circuit Court of Kanawha County?

A. Mr. Townsend, you stated in the beginning that we are counsel for Fidelity. May I ask that you correct that and tell me whether or not the record shows that we are still counsel for Fidelity, because, if I understood, Mr. Fleming was appointed counsel for the company later on, and I just assumed that that meant we were cancelled out as counsel for Fidelity.

Mr. T. C. Townsend: There is nothing in the record so far as I know, that cancels your attorneyship.

Mr. Palmer: No, I think Mr. Townsend is right, your Honor; there is nothing showing any right of Mr. Fleming [fol. 3707] or Mr. Ray to appear in these proceedings on behalf of Fidelity, and we have raised that objection before, that they have no right to appear as counsel here without the authority of the corporation, and we renew that objection.

The Court: Overruled.

Mr. T. C. Townsend: Will you answer that question?

A. I will answer that question and say that if there were any particular reason why we couldn't represent these receivers as against anybody because of close association or whatnot, we certainly would step aside and the attorney general would appoint somebody else to prosecute the case.

Mr. T. C. Townsend: Will you read the question, please?

(The question was read.)

Q. Can you answer that question yes or no and then make such explanation as you care to make?

Mr. Palmer: I object to that, your Honor. I think the witness has answered the question with a proper explanatory answer.

Mr. T. C. Townsend: I think his answer is equivocal. [fol. 3708] The Court: No, it struck me that he answered the question. The question, however, is objectionable, although no objection was made to it, in that it wouldn't make any difference whether they were proceeded against in the Circuit Court of Kanawha County or in the Circuit Court of California.

Mr. T. C. Townsend: That is right, your Honor, but I only used that because that is the only suit that is pending.

The Court: Well, you are confusing the suit that is pending with suits that may be brought to enforce the same liability. It doesn't make any difference, as far — I see, where the suit is to enforce the claimed liability for fraud; the question is whether the proceeding in the circuit court or the proceeding in the federal court is a more available and suitable way of arriving at a point where such suits can be brought, not as to whether those suits are proper one place or another.

Mr. Townsend: I think that is right. It is a question of which courts could furnish the best relief.

The Court: Yes, but don't confuse the courts in which these proceedings are pending with the courts in which some [fol. 3709] suit may be brought against some person that is alleged to owe money.

Mr. Palmer: If your Honor please, I would like to note another objection to that. It is not a question of the Circuit Court of Kanawha County. If Fidelity brings an action to recover it would have to be brought by the Attorney General as attorney for the plaintiff, Edgar B. Sims, who filed that suit, or the action, if need be, be brought by his agents, the West Virginia State Court Receivers. I think the distinction should be made in the question that if it is for the purpose of collecting the assets of Fidelity, then under the statutes of West Virginia that suit would be instituted by the State Auditor, who is represented, as the record shows, by the Attorney General in this suit. However, if it should be a matter of getting something that was outside the State of West Virginia, there would have to be some other persons appointed to handle that suit and it couldn't be that an action could be brought by the West Virginia State Court Receivers outside the State of West Virginia, because of the territorial limits of the West Virginia court.

[fol. 3710] The Court: Well, that particular distinction is largely technical; because if the state line were all that prevented the receivers from bringing the suit, the receivers would certainly have to do some act to associate some ancillary receiver or to instigate a proceeding at the hands of some ancillary receiver.

Mr. Palmer: I agree with your Honor, but the point I was making was that there is a distinction between whether it was an asset of Fidelity that the Auditor should collect and the Attorney General should bring the suit, or whether it is something that the receivers should take into their possession, as to whether or not Mr. Koontz's firm or the Attorney General should instigate such a suit, and the question does not make that distinction.

The Court: I think that is close enough, in view of the facts that have been brought out as to the character of this proceeding and the close association between the Auditor's office and the receivers, and particularly the firm of Mr. Koontz.

Mr. T. C. Townsend: Now, Mr. Koontz, will you answer the question yes or no and make such explanation as you [fol. 3711] care to make.

A. I would say yes, that I would have no hesitancy in advising what the rights are in connection with this receivership any more than a representative of the trustee would have a connection with the trusteeship, and if because of some personal relationship we couldn't go ahead and prosecute the suit fully, we would step aside and the Attorney General would certainly choose somebody to go ahead and prosecute the suit, and I don't say—mention that limitation—talk about personal association—I don't think of any personal association that would retard any affirmative action on our part.

Q. Or any business association?

A. Yes, personal or business.

Q. Or any association otherwise?

A. Yes, that is true.

Mr. T. C. Townsend: Your Honor, I would like to introduce the minutes—oh, they have already been introduced; Exhibit 97. That is the minutes of April 7.

The Court: You say they have been introduced?

Mr. T. C. Townsend: It is so marked here.

The Court: Then all you have to do is to refer to them.

[fol. 3712] Mr. T. C. Townsend: I had not noticed that. I don't care to ask any questions about it. Yes, I will ask this question.

Q. That is one of the original letters you spoke to me about?

(No answer.)

Q. You received that letter?

A. Yes, sir.

Q. Is that the first notice you had of your appointment as attorney to represent Fidelity?

A. It was, yes, sir.

The Court: I think you ought to let the record show what you are talking about.

Mr. T. C. Townsend: I am talking about the resolution that is contained in this letter—the resolution of April 7, 1941, that purports to be contained in that letter.

Mr. Palmer: What is the date of the letter please?

The Court: You ought to identify the letter on the record so we will know what letter you are talking about.
[fol. 3713] Mr. T. C. Townsend: Have you got a copy of it?

A. No, I don't have. That is read in the record, however.

Mr. T. C. Townsend: This letter has been read into the record.

The Court: But your question doesn't show that that is the letter you are talking about.

Mr. T. C. Townsend: I am aware of that. We will put it this way. On yesterday there was read into the record a letter dated April 10, 1941 addressed to the firm of Koontz & Koontz, Union Building, Charleston, West Virginia, and signed by F. J. McNulty, Vice-President and Secretary of Fidelity Assurance Association. That letter purports to contain a resolution passed by the board of directors of Fidelity with reference to employing your firm to represent Fidelity in the state court proceedings. My question was, is that the first notice you had of your employment?

A. It was, sir. With this verification from somebody—we were in touch with Wheeling quite often. Someone may have told us by phone that there had been such a resolution passed. But we received no notice after the [fol. 3714] passing of this resolution.

Q. You had talked about the state court proceedings to the board of directors prior to the resolution?

A. I talked to Mr. Foulk and Mr. Marshall, and, as I say, probably to Mr. Risley, and there may have been some other individuals. Mr. Townsend, remember, I had not been a member of the board for over a year, and I wasn't attending board meetings.

Q. Mr. Messick made the statement at that board meeting that on April 4, 1941 he had been informed that there was imminent danger of legal proceedings being instituted by the Auditor and Ex-officio Insurance Commissioner of the State of West Virginia, and that this meeting was called to inform the directors. Did you talk with Mr. Messick about it?

A. Oh, yes, a number of times.

Q. Did you talk to him on April 4th?

A. On April 4th or 5th Mr. Messick was in Washington, and I met him there and talked to him at some length.

Q. Then you told Mr. Messick when you talked to him at that time all about the understanding between yourself and the Auditor in reference to the institution of this pro-[fol. 3715] ceeding in the state courts?

A. I told Mr. Messick what my advice had been, yes, sir.

Q. All right.

A. Yes, sir. I discussed it with him and discussed the various angles from a state court point of view and a federal court point of view.

Q. Mr. Koontz, did you attend the meeting of the board of directors in Pittsburgh on June 3, 1941?

A. Did I attend?

Q. Yes.

A. No, sir, I did not.

Q. Were you notified that they were holding a meeting?

A. I was notified that they were to hold one, yes.

Q. You were not a member of the board of directors at that time?

A. That is true.

Q. Did you attend the stockholders' meeting held in Wheeling last week?

A. No, sir, I did not.

Q. Were you notified of that meeting?

[fol. 3716] A. I heard about it. I am not sure a notice came. I don't believe I saw a notice, but that doesn't mean that one didn't come. I heard about the meeting to be held up there. Mr. Townsend, I am still a one share stockholder. I just assume the notice was mailed to all the stockholders. So far as I know I am a one share stockholder.

Q. That is all you ever held.

A. That is right. (Laughing.)

Mr. T. C. Townsend: That is all.

The Witness: Relative to some meetings in Washington which were talked about before, I desire to make the following statement relative to dates. The main and larger meeting was held March 17th in the office of Mr. Chester Lane. At the conclusion of that meeting it was decided that a smaller committee should work on plans briefly dis-

cussed at that meeting, and that there should be another meeting a little later on. The meeting set for later on was delayed, and the principals again met in Washington on the last day of March and the first day of April for further discussion.

[fols. 3717-3727] Cross-examination.

By Mr. Huwe:

Q. Mr. Koontz, as I understand it you favored a reorganization in the form of an insurance company—at least, that was your attitude prior to and during the state court receivership?—Is that correct?

A. State the question again, please.

(The question was read.)

A. I felt that that was the only practical way to reorganize this company, in the insurance field or in some other field rather than in the face certificate field.

Q. Have you familiarized yourself, as attorney for Fidelity, with the insurance laws of the various states with respect to either administrative rules or provisions of law requiring a two year operation in the domestic state before being given permission to operate in the foreign state?

A. I know some states have that requirement. I think some have one year and some two years; I am not familiar with all of them.

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[fol. 3728] Q. Mr. Koontz, in the proposed SEC report of 1939, that is, the debtor's report prepared by your law firm, I think Mr. Ross Thomas performed the major part of that operation, did he not?

Mr. Palmer: I suggest that Mr. Huwe call it registration statement instead of debtor's report.

The Court: That would indentify it better, because that is what it has been called heretofore.

Mr. Huwe: Well, I stand corrected—call it the registration statement with the SEC. That was proposed and completed in 1939? Is that correct?

A. That is correct.

Q. What method of evaluation was used in that statement? Market?

A. Doesn't that speak for itself?

Q. Or West Virginia sound—do you know?

A. Well, I did know, but I forget.

[fol. 3729] Q. Is that in evidence, that registration—

Mr. Palmer: I don't think so.

Mr. Huwe:

Q. You wouldn't state from your own knowledge—

A. Market was in there, but I think some other methods were used too.

Q. You are sure you used market?

A. I feel sure—

Mr. Huwe: Mr. Thomas will verify that.

Mr. Thomas: The matter of valuation was a part of the accounting work on the report, which was prepared by Haskins & Sells. As I recall, the valuation was given both as to market, book and sound value.

Mr. Huwe: Thank you.

Q. Who drew the amended charter—your law office took care of that, did they not, the 1941 amended charter?

A. We took care of filing it.

Q. Changing it from an insurance—

A. Yes. We took care of filing it. As I recall, that was drawn by someone else.

Q. Oh, it was?

A. Yes.

[fol. 3730] Mr. Huwe: That is all.

Cross-examination.

By Mr. Ray:

Q. Mr. Koontz, you have testified that during the years 1938, 1939 and 1940 you were in touch with some twelve or fifteen financial houses for the purpose of securing money with which to rehabilitate Fidelity. Is that true?

A. That is true.

Q. At the time you were engaged in these negotiations, were you of the opinion that Fidelity was a company which should be rehabilitated and which could be rehabilitated?

A. I was.

Q. I would gather from what you have testified here that during your conversations with Mr. Marshall, with Mr.

Messick, Mr. Fleming, Mr. Sims immediately prior to the institution of the state court proceedings, that you were still of the opinion that Fidelity was an organization which should be rehabilitated and reorganized and could be rehabilitated and reorganized. Is that true?

A. That is true. Explaining, however, that we had been converted into an insurance company, and it was a question of going ahead in that field and carrying on the business that you already had on the books and putting more business of like kind on the books if it were profitable.

Q. Well, it was your opinion that there was a place in the economic life of this country for a business such as this? Were you not of that opinion?

A. I was more of that opinion a few months ago, Mr. Ray, than I am right at the present time.

Q. That is, what I am asking you, about a few months ago.

A. That is true.

Q. My question referred to a time prior to the institution of the state court proceedings. That was your opinion then?

A. That this business on the books could be carried on profitably if we could get this coupon cut down. That was always our plan—scheme of things.

Q. And you thought it was a business which should be carried on?

A. The business on the books, yes, sir.

Q. I mean, you thought that this principle of selling thrift [fol. 3732] was a business which was for the public interest of the people of the country as a whole, did you not?

A. I always liked it very much if you could get it on a sound basis where you could earn what you promised to earn.

Q. And if it was properly managed and performed what it held itself out to perform, it was a good thing for the people as a whole, was it not?

A. I always felt that any thrift plan was a good thing if you put it on the right basis.

Q. And during your discussions with Mr. John Marshall, Sr., those discussions were solely with the view to reorganizing and rehabilitating this company, were they not?

A. That is true, yes, sir.

Q. And when the bill of complaint was filed in the state court, one of the prayers contained in that bill was "that all proper orders and decrees may be entered for the purpose of rehabilitating and reorganizing the defendant Fidelity Assurance Association"? Is that not true?

A. I assume it is. You are reading from it.

[fol. 3733] Q. You were familiar with the bill?

A. Yes, generally, yes, sir.

Q. Do you want to examine the bill?

A. No, not at all. I will say yes to the question, if it is all right.

Q. I would prefer that you do examine it here. (Handing witness paper.) Now, will you state on the record whether that is one of the prayers of the bill?

A. It is.

Q. I understood you to testify that prior to the institution of the state court proceeding you were unable to obtain any expressions of opinion from the Securities and Exchange Commission or from any member of the Commission or from any responsible department head of the Commission as to the court in which the reorganization of Fidelity should be attempted. Is that correct?

A. I think so. I never talked to any member of the Commission at all.

Q. Well, I say that was your testimony—

A. I think so.

Q. (Continuing.) And the only advice you could get over at the Commission from anybody was that that was a question [fol. 3734] which the party which instituted the suit would have to decide.

A. That is right.

Q. Is that your testimony?

A. "You gentlemen will have to choose your forum."

Q. Mr. Koontz, it is in evidence here that Commissioner Healy, of the Securities and Exchange Commission, wrote a letter to Mr. John Marshall, Sr., in May 1941, and that Mr. John Marshall sent you a copy of that letter, and in that letter, which has been read into evidence here, is a statement to the effect that you were advised several weeks prior to the writing of the letter that it was the feeling of Mr. Healy, and not the official action of the Commission, but of those connected with the Commission, that the reorganization of Fidelity should be undertaken under the provisions of Chapter 10 of the Bankruptcy Act.

Mr. Palmer: If your Honor please, I do not want to object to that question, but I think Mr. Ray has quoted as nearly as anyone could from memory the portions of the letter to which he refers, but I think that perhaps the exact parts of Mr. Healy's statement should be used rather [fol. 3735] than an attempt on the part of any counsel to try to remember what that was, because there has been some discussion heretofore as to the exact content and meaning of those particular phrases.

The Court: I see Mr. Koontz looking for the letter.

The Witness: I am not sure that I have it. I have not seen that letter for some time. I don't know Mr. Healy; I don't know that I have ever met him. I never talked to him about this matter. That could still state the absolute views, for this reason, that, as I said yesterday, after this proceeding was filed and for some time thereafter I saw a number of times Mr. Schencker in Washington, who was head of a particular division of SEC, and he did say that his idea was that we would get better results under Chapter 10, but that was after our state proceeding was filed.

Mr. Ray: I did not get to complete my question, Mr. Koontz.

A. Beg your pardon.

Q. I was going to ask you, did you receive a copy of the letter which Mr. Healy wrote to Mr. Marshall?

A. I did.

[fol. 3736] Q. When you received the letter, did you write Mr. Marshall and notify him that the statements contained in the letter about the information given to you with respect to the opinion of the Securities and Exchange Commission was incorrect?

A. I am not sure that I wrote him.

Q. Well, would you examine your file and tell us whether you have a letter to Mr. Marshall in which you advise Mr. Marshall that the statements made by Commissioner Healy are not correct?

A. I shall, but I don't remember any such letter, and I think if I were disputing a member of the Commission of the SEC I would certainly remember it. I did talk to Mr. Marshall a number of times, however, and did tell him exactly what Mr. Schencker had said. I told him also about the former discussions with which he was already familiar.

Mr. Ray: I would much prefer to ask the witness the exact language contained in the letter, but it has not been introduced in evidence. Certain portions were read into evidence, which it may take a long time to find. If counsel thinks I have materially misquoted it—

[fol. 3737] The Court: The question is fair enough to be propounded, I believe. It is not necessary to have the exact words.

Mr. Ray:

Q. Mr. Koontz, what authority is there in the statutes of West Virginia or under the chancery practice of West Virginia for the reorganization of a corporation in a state court proceeding?

A. We have no reorganization statute in West Virginia, of course, as you know, but under your general equity powers of the state court you can reorganize.

Q. Then when you recommended that this proceeding be brought into the state courts, you knew that the receivers of that court would not have any authority or control over the assets of the corporation which were situate without the boundaries of West Virginia, did you not?

A. That is right.

Q. And you knew that the total of those assets was approximately ten million dollars?

A. Yes.

Q. You knew when you recommended this state court proceeding that there could be no reorganization of Fidelity [fol. 3738] in that proceeding unless every holder of common stock, every holder of preferred stock, every holder of a contract and every creditor, both secured and unsecured, would agree thereto, did you not?

Mr. Palmer: Objection.

The Court: In my opinion that is not a fair question. It should contain something further, that is, the qualification that those who did not agree to it be paid off their full equities, with the consent of those who did agree.

Mr. Palmer: That is right. That is what I had in mind.

A. You would have a hundred per cent reorganization in the event you could carry out the suggestion made in your question, Mr. Ray, where you could have a reorganization that could be very effective without the consent of all the people you mention.

Mr. Ray:

Q. Will you explain how, in a state court proceeding, you could have a reorganization of a corporation without the consent of all the stockholders and all the creditors?

Mr. Palmer: If your Honor please, if the stockholders [fols. 3739-3742] are shown, as in this case, to have no equity, you need no consent from them, if they have nothing left in the corporation.

Mr. Ray: If you want to take the stand to answer the question I will be perfectly willing to call you in a few minutes.

Mr. Palmer: I will be glad to do that, Mr. Ray, but I was making an objection to the Court.

The Court: Mr. Palmer is just objecting to the questions, and I think the question fails to take into consideration the fact that the Court mentioned a little while ago that there may be a reorganization without the consent of everyone, if those who do consent are willing that the ones who don't consent be paid off.

Mr. Ray: I expected that was the answer the witness would give to the question. I asked him how it could be effected, and I presumed that is the only way it could be effected.

The Court: That is a legal conclusion.

[fol. 3743]. The Court: Let's let Mr. Koontz explain that and get away from it. We are taking too much time. Go ahead, Mr. Koontz.

A. In 1940, after Rosset and Messick came in and became active and were having work assigned elsewhere, it was a question of settling with our firm, and discussion was had before the executive committee. As I remember, it was the executive committee, either the executive committee or directors' meeting in Wheeling; and a committee was appointed to check over and report back what fee they thought the firm of Koontz & Koontz was entitled to. On that committee [fol. 3744] were Mr. John Marshall, Mr. Tom Foulk, and I am not sure but what another member or two; however, those were the active people. At our next meeting they did report back that they thought a fair fee would be a certain amount, as I remember that was \$20,000, to finish paying the fee for all the work done. That was reported back to the next meeting and was accepted and ap-

proved, and some time after that was paid, but that is the way the final settlement on the larger payments was handled. That was the first half, I would say along about May or June, of 1940.

Mr. Ray: Q. You don't know whether that was ever adopted—

A. It was adopted—

Q. At a formal meeting of the executive committee—

A. It was adopted. It was; a committee was authorized in one formal meeting and the report made back to another formal meeting and passed.

Q. Well, the minutes don't show it, that I have been able to find.

A. I think that you will find that in an executive minute, and then that minute adopted later by your board of directors.

[fol. 3745] Q. After you leave the stand—

A. I will try.

(Q. (continuing): Find out if you can, and if you find it I would like to have it introduced in evidence. Mr. Koontz, before I took part in these proceedings, in reading through the transcript, I have seen that there were some references to the fees received by your firm during the years 1938, 1939 and 1940, and since I have been here the matter has been discussed on one or two occasions, and I would like to know whether Mr. Palmer reported to you what has taken place here at the hearing in that respect?

A. Generally that there was a report made in here showing the fees of our firm, and that those fees had been discussed from time to time.

Q. You had knowledge that the fees had been discussed here?

A. That is true. That is true.

Q. Do you not keep records in your firm showing each day what member works on a matter and how much time he spends on it?

A. We do. My secretary keeps my own record, and the [fol. 3746] bookkeeper keeps a general record.

Q. It is kept for every member and every associate of your firm, is it not?

A. That is true.

Q. Mr. Koontz, you were present in Washington at the meeting at which these plans prepared by Mr. Latta were

discussed with the Securities and Exchange Commission were you not?

A. Yes, I was.

Q. Mr. Palmer produced two of these plans here a day or two ago in this hearing, and when asked where they came from he refused to answer. Did they come from your files?

A. Frankly, I don't know.

Q. You had copies of those plans in your files did you not?

A. You say "those plans". I have had copies of many plans—several plans of discussions and digests and what-not, from Latta, from Messick and from Risley.

Mr. Palmer: They came from associates of the firm of Koontz & Koontz and from their files. Mr. Ross Thomas and Mr. Goldsmith gave them to me to look at.

[fols. 3747-3748] Mr. Ray: The exhibits to which I refer are Exhibits Nos. 111, 112 and 113, are they not, Mr. Palmer?

Mr. Palmer: Yes.

[fol. 3749] Q. Mr. Koontz, when you first went with the company as a director in 1932, there is no doubt about it that Fidelity was in some financial distress? Isn't that correct?

A. That is correct.

Q. And you, not having any financial interest in the company, and being put on the board of directors presumably because of your experience and your ability as an attorney, used both your experience in financial matters together with your abilities as an attorney to aid in correcting that situation? Is that true?

A. I did.

Q. During the years from 1933 on, after Mr. Sims became State Auditor, did you from time to time have conferences with Mr. Sims?

A. I did.

Q. Did he more or less come to you as intermediary between himself and the company?

A. Quite often he did, that is true.

Q. And did he discuss the various problems which he, as state auditor, felt that he had in relation to the company?

A. He did. I don't know whether that would be exclusive, but he did discuss the company's problems many times.

Q. As one of the problems, did he discuss with you the

fact that in his opinion the salaries of the officers were too high, and ask you to bring that to the company's attention and take corrective steps?

A. Yes, he discussed that with me, and also that the officers—Senator Sutherland came down here and was present at Mr. Sims' office. He didn't confine that discussion to me, but various officers that represented the company.

Q. And did Mr. Sims, in his conferences with you, protest the amount or highness of the officers' salaries?

A. Oh, yes, he did, and there was a schedule of salaries agreed on at the time Mr. Sutherland was president.

[fol. 3751] Q. Did you convey that information to the company, that Mr. Sims demanded that salaries be decreased?

A. I don't remember that that was done with me personally. If it was, I conveyed it; but I think Senator Sutherland understood that direct action was taken in accordance with a schedule that was set up.

Q. With reference to the National Sales company—

A. May I go a little further? Mr. Sims appeared before the board of directors a time or two and discussed these various matters you are talking about.

Q. With reference to the National Sales company, did you have knowledge that Mr. Sims appeared before the board of directors or before the officials of the company and ordered them either to close up the National Sales company or he would close Fidelity?

A. I have knowledge of his appearing before the board of directors one or more times, once in Washington, as I remember it, and I think probably once in Wheeling; and he never liked the side company handling the business of sales of Fidelity. I don't know just what statement he made about closing up the whole company if they didn't do it immediately or what that was, but his idea was that should [fol. 3752] be eliminated.

Q. In substance, National Sales company, in their contract, were to receive certain commissions for the selling of Fidelity bonds. Isn't that true?

A. It is.

Q. And in actual practice the company advanced them further moneys with which to expand their selling facilities. Isn't that true?

A. It is.

Q. After National Sales company was out of existence, or no longer played a part in Fidelity, isn't it true that the

selling force which Fidelity itself gathered together not only received its commissions, but the company had certain expenses in connection with selling their contracts, advertising and so forth, which could be compared with advances made to National Sales for the same purposes?

A. Well, we had the expense, no matter whether we sold through an agency outside or sold direct, of course.

Q. In other words, after Fidelity started selling direct, after Mr. Carroll Evans had a very handsome salary as head of the entire sales organization, they had Mr. Reed,

Mr. Pulfer and various other ones who were partly on [fol. 3753] salaries and partly on commissions to handle the sales ends, you had selling literature prepared, you had offices to procure and furniture to buy? Isn't that all correct?

Mr. Ray: Your Honor, I don't know what this is cross-examination of, but it has certainly already been introduced heretofore.

The Court: Overruled.

A. That is correct.

Mr. Palmer:

Q. So that the amounts the company advanced to National Sales were, in the opinion of the company, necessary for aiding in the selling of Fidelity contracts, if you know, isn't that true?

A. Well, I would assume so. Most of those advances were made before my connection with the company.

Q. Now, with reference to Mr. Messick, didn't Mr. Messick get the advice of Mr. Weaver, of Chicago, an attorney who specialized in insurance matters, with reference to the transformation of Fidelity into an insurance company?

A. Oh, yes. That is where he got most of his advice, I understood.

[fol. 3754] Q. And with reference to the question asked by Mr. Huwe about the various state laws, isn't it true that Mr. Weaver, after considerable study, prepared a legal brief for Mr. Messick in which his conclusions were that Fidelity for some years had been an insurance company, and that therefore it could qualify immediately in the various states.

Mr. Huwe: I object to that.

The Court: Overruled.

Mr. Huwe: I object specifically to the legal conclusion that Fidelity had been an insurance company for a number of years.

The Court: He is not asking for that legal conclusion. He is just asking whether or not Mr. Weaver prepared a brief in which he said that.

A. A report was prepared by Mr. Weaver, and then some very long letters in the nature of a brief were prepared by Mr. Weaver, in which he did take the position that Fidelity had been in the insurance business for some years and was really conducting an insurance business because of the fact that it insured its contract holders.

[fol. 3755] Mr. Palmer: And that for that reason it could comply with the state laws and requirements that an insurance company should have been in existence for so long—was that his conclusion and advice to Mr. Messick?

A. I don't know what he advised Mr. Messick particularly. I think that was his argument. We had already been in the insurance business for some time. I am not saying we took that.

Q. And it was on the basis of that opinion or series of opinions that he arrived at the conclusion that it was felt by the officers and attorneys that Fidelity could go ahead and attempt to rehabilitate itself as a going-life insurance company?

Mr. Ray: If it please your Honor, we object to the admission into evidence of some opinion which has not been offered or any testimony about it.

The Court: Overruled.

A. Well, Mr. Weaver, who was brought in by Mr. Messick as an attorney, was the prime mover along the line of promoting the insurance business for Fidelity, and he was the one that was in conference with them in Chicago many times, came down here and was here for several days and [fols. 3756-3760] went to Wheeling and stayed for some time.

[fol. 3761] Q. How active was Mr. John Marshall in getting you to go with Fidelity and getting you to stay with Fidelity?

A. Well, he not only asked me; he rather insisted on my going, and, as I said in my testimony yesterday, I refused to go in the beginning, and they elected me a director without my knowledge or consent and just notified me of it in the beginning, and then from time to time we would talk about whether I should stay on any longer, and especially was that true after the company had apparently been rehabilitated and had gotten up to where they said they were making money in 1937. I talked to him about resigning from the board of directors and he insisted that I should not.

Q. Did you attempt or desire to resign from the board of directors after having been with a more or less sick company that had become well and on its feet—

A. I did, and talked it over with him and talked it over with Colonel Thompson. They insisted on my not resigning.

Q. You told them that you had finished your job and that the company was well—is that correct—or substantially that?

A. That is it.

Q. Did you have any correspondence with Mr. Marshall indicating his desire to have you either stay on with the company or come back to it after you had resigned from the board of directors?

A. Yes, more conversation than I have correspondence, however. He requested me many times to come back to the company and give it more time.

[fol. 3768] Q. Did Mr. Marshall talk to you about the retention of his son Jack as an employee of the state court receiver?

A. Mr. Palmer, I am not sure that he did. A number [fols. 3769-3772] of these people employed there did. I am not sure that—I am sure that Jack never mentioned it. I am not sure that his father mentioned it. His father seemed disappointed after Jack was let out that he had been let out, but I am not sure that he ever asked me to retain him.

[fol. 3773] Mr. Palmer: Now, Mr. Koontz, you have talked with a number of persons of more or less high financial repute throughout the United States, and you have been a director in a bank and still are a director and vice-president of a bank, and you were a director on the various committees of Fidelity for some years. Have you reached a conclusion as to what can or should be done with Fidelity in the future?

The Court: You mean an opinion?

Mr. Palmer: An opinion would be synonymous with conclusion, your Honor.

A. Well, I should like—am I permitted to answer?

The Court: Yes, he wants to know if you have reached an opinion.

Mr. Ray: Your Honor, I object to this question being asked on rebuttal. That is a question which certainly should have been asked on direct examination and give opposing counsel an opportunity to cross-examine this witness on that question.

The Court: You are right about that, but I am not going [fol. 3774] to confide this very strictly, and therefore if something new is brought out you will be given the opportunity to cross-examine.

A. Of course, I should like very much to see this reorganization. I am of the opinion, however—and if I may be permitted to use the same wording that you say Mr. Marshall used, it is based on discussions with people who know much more about financial matters than I—I am of the opinion that it cannot be reorganized and operate in the field which it has been heretofore operating solely.

Q. That field being face amount certificates?

A. That is right.

Mr. Ray: Show an objection, your Honor.

The Court: Overruled.

A. A reorganization must be accompanied by marking down the rate of interest for reserves and a change generally in the business in the future.

Mr. Palmer: Have you formed or reached an opinion or conclusion as to whether or not Fidelity could succeed by being reorganized into a going life insurance company?

Mr. T. C. Townsend: Into a what?

[fol. 3775] Mr. Palmer: Going life insurance company.

Mr. Ray: Show an objection, your Honor.
The Court: Overruled.

A. Well, I would say under the present situation that that would be about the only chance of reorganization it would have.

[fol. 3776] Mr. Palmer: "Charleston, West Virginia, the 11th, 11:35 A. M.

Honorable Allen G. Pflugradt, Chairman, Banking Commission of Wisconsin:

I have decided that my department should take over the affairs of Fidelity Assurance Association to administer same and work out sound rehabilitation and have filed suit in an appropriate state court asking for receivers and other relief. Reserve funds for contracts issued since 1932 seem solvent at market, and all funds as whole seem solvent at convention values or impairment is small, but association [fols. 3777-3779] is suffering overhead and other losses. My action will prevent impairment from becoming serious. Copy of bill being sent you by mail. I earnestly urge that you apply in your official capacity for ancillary receiver of assets in your states.

Edgar B. Sims, State Auditor, Insurance Commissioner."

And I think it already has been stated and agreed that that was sent out to some sixteen states. Am I correct in that, Mr. Townsend?

Mr. T. C. Townsend: Well, I assume it was sent to all the states where there were deposits, but I don't know whether there was any agreement about it or not. I am not objecting to it.

Mr. Lauritzen: Mr. Townsend, I wonder if it might not have been sent to all states where Fidelity had assets, whether deposits or otherwise, such as Texas, or anything of that sort.

Mr. Townsend: I don't know. You might ask Mr. Sims.

Mr. Lauritzen: Mr. Sims advises that he believes it was sent to twenty some states.

[fol. 3780], Mr. Palmer:

Q. Mr. Koontz, what, if any, part in arriving at the decision of yourself and others, members of the board of directors of Fidelity to proceed in a state court did the fact that the company had for many years advertised the [fol. 3781] West Virginia law and advertised to the contract holders that they, if ever the need came, would be guided by their liquidation in that law—did that have on your decision, or did it play any part in your decision or preference between the federal and state court?

Mr. Townsend: The question was answered yesterday. That information was given by this witness in reply to questions I asked him.

The Court: I don't remember if it was. I overrule the objection.

A. It did. These statutes had been advertised in the selling campaign by putting the advertising in the literature from time to time and referred to, so I felt that as between the two, if everything else were equal, that you should follow your state statute because they had been used in your selling campaigns.

Mr. Palmer: Do you have any of the literature that was issued to the salesmen in that regard with you, Mr. Koontz?

A. Six booklets were put out some time ago as a sales course, and I have very little of the sales literature in [fol. 3782] my office, but I did have these books, this sales course, left over; and some references are made in book number five as to what the salesman should tell the prospect.

Mr. Palmer: I am going to ask the Court's permission to read one paragraph from page 28 of Book 5. I don't think it would be pertinent to introduce the entire book. The book is entitled, "How to Win the Final Decision," and shows a Fidelity subscription with two gentlemen shaking hands above it with a fountain pen, and it is entitled, "Training Course for Fidelity Career Men," and is copyrighted by Fidelity Investment Association.

Mr. Jaegerman: Before we have it read, could we have the approximate period when that book was used?

Mr. Palmer: It is copyrighted 1936.

Mr. Jaegerman: Does Mr. Koontz know?

The Witness: Sometime after that. I would say in 1937 was when it was used. It was when they were going pretty well. Copyrighted in '36-'37 and possibly '38—that is, sales training courses during those years. These came out periodically over several months.

Mr. Jaegerman: Would they be approved by the directors? [fol. 3783]

A. They had what is known as an advertising committee representing the directors. Somebody from Chicago, an advertising man, was head of that committee.

Q. Were you on that committee?

A. No, I was not.

Mr. Palmer: There was just a paragraph in the pamphlet which I deemed important. The first one is the first paragraph on page 28. "When the prospect has once again agreed to the second buying decision, you proceed by saying, 'In view of Fidelity's splendid record, together with the important legal safeguards which it provides, there can be no question in your mind as to Fidelity's absolute dependability and safety in fulfilling its share of the plan, can there?'"

Now, on page 55, next to the last paragraph, under the heading "Objections to Decision Three, the Institution Behind the Plan," the sub-heading "Is My Money Safe With Fidelity?" and the first paragraph in quotes begins, "Mr. Prospect", and the second paragraph, "Fidelity has always been guided by the soundest and most conservative principles of investment, safety, security and sound conservatism [fols. 3784-3785] have always been and always will"—the word "will" being emphasized—"be the first consideration in the investment policy of this institution. The loss of a single penny to any contract holder is a possibility quite remote, made doubly remote by the many rigid state laws and the departmental supervision under which Fidelity operates."

[fols. 3786-3788] Q. You didn't ever get any new capital in all your efforts?

A. That is right; that is right.

[fol. 3789] H. ISAIAH SMITH recalled, testified as follows:

Cross-examination.

By Mr. Farmer:

Q. Mr. Smith, how many contract holders made payments to the trustee on contracts during the month of September, 1941? Have you that information by the various series of contracts?

A. Yes, I have.

Q. Will you give that, please?

A. I am advised by the office that the records show that the following payments were received on contracts for the month of September: Special Income contract account, 4 payments were made on contracts; special annuity contract account, 270 payments were made on 224 accounts; [fol. 3790] income reserve contract Series A account, 247 payments were made on 196 contracts; income reserve contract Series B account, 3,055 payments were made on 2,254 contracts; income reserve contract Series D account, 131 payments were made on 95 accounts, making a total of 3,707 payments on 2,773 accounts.

The Court: I would like to know, Mr. Smith, whether or not these contract holders have been advised by the trustee as to whether or not they should continue making payments and what, if any, effect that would have on their rights in this proceedings.

A. The contract holders have been advised by both the receivers—if I may include the receivers—and the trustee that none of their equities will be lost by failure to keep up the regular monthly payments.

Mr. Farmer: That advice that you spoke of, was that in one of these form letters—one or more of these form letters that has already been filed in the case?

A. I think those exhibits will contain that information.

Q. Do you remember which one?

[fol. 3791] (No answer.)

Q. Are you referring to the letter of July 3rd (handing witness paper).

A. No, a subsequent letter. •I don't see it in this letter right off, but there has been a letter gone out from the trustees to the effect that no equities will be lost by rea-

son of the failure to keep the monthly payments up, and also we have answered, I would say, thousands of letters individually, when they would write in and ask specifically what would happen to their contract if they didn't keep the payments up. In all cases we have told them that their equities were fixed as of the date of the appointment of the trustee.

Q. I want to get just exactly what that advice was in these circular letters.

A. Here is the paragraph in the receivers' letter. "One effect of the receivership has been to fix your status as a creditor as of the date of the receivership."

Q. What letter is that you are referring to?

A. That is the receivership letter.

Q. That is in Exhibit 32 you are referring to?

A. Yes.

[fol. 3792] Q. Well now, the sentence that you referred to is this in that exhibit, is it not?

A. That is right.

Q. "One effect of the receivership has been to fix your status as a creditor as of the date of the receivership, both as to the amount of your claim and with respect to the particular assets held to satisfy the same." Is that the sentence you are referring to?

A. Yes.

Q. Have you got there any communication from the trustee telling them that they didn't have to pay?

A. It is not in this exhibit. There has been a statement sent out by the trustee which gives a running narrative of all these proceedings. I don't happen to have one with me, but I could get one from the office.

Q. Is that a circular letter?

A. It was sent out in answer to inquiries.

Q. A prepared form for use in answering inquiries?

A. That is right.

Mr. Farmer: I would like for you to get that. I thought that we had all the circular communications.

A. It was sent out—prepared about a month ago.

[fol. 3793] Q. Do you find here a notice from the Central Trust Company, trustee, to the owners of Fidelity Assurance Association Series B contracts dated August 22, 1941?

A. No, I don't see that.

Q. That was apparently in among those notices that were filed at the previous hearing?

A. If I recall, these were filed during the first hearing in August.

Q. That is right. Yes. I hand you a notice dated August 22, 1941, and will ask you if that was a form of notice that was sent out by the trustee about that time to all contract holders?

A. It was sent to the owners of Series B contracts that had insurance protection.

Q. And I will ask you to file that copy as Exhibit No. 117.

Exhibit 117

(The paper referred to was filed, marked as above indicated, and is attached hereto as a part hereof.)

Q. That letter tells them, doesn't it, that it will be necessary for the owners of Series B contracts, where Section [fol. 3794] 6 is effective (providing for insurance protection) to make full payments if they want to keep their insurance in force? That sentence is in that letter?

A. That is true. That is correct, if they want to keep their insurance in force; but failing to pay would not affect the equity in their contract as it existed at the date of the receivership or the appointment of the trustee. The only feature that would be dropped on the Series B contract would be the insurance protection only.

Q. And that also tells them that in order for contract holders who have taken advantage of the previous three month grace period to have the opportunity to bring their contract payments to date, this requirement will become effective on August 31, 1941, by which time all payments now due or past due, including the payment for interest, must be made?

A. That is right.

Q. You were asked on the stand about the notice of deficiency assessment by the Commissioner of Internal Revenue?

A. Yes, sir.

[fol. 3795] Q. (Continuing.) For income taxes. That assessment, you said, was for the taxable years 1935, 1936, 1937, 1938 and ten months of 1939?

A. That is right.

Q. And that was your income and excess profits taxes for those years?

A. That is right.

Q. You said that amount was approximately \$260,000?

A. Approximately \$265,000.

Q. Is this a copy of the notice of assessment dated May 20, 1941, to the receivers?

A. Yes, it appears to be.

Q. Will you file that as Exhibit No. 118?

Exhibit 118

(The paper referred to was admitted in evidence, marked as above indicated, and is attached hereto as a part hereof.)

Q. State whether or not there was a supplemental proof of claim filed with the receivers which brought the total claim for income and excess profit taxes for those years up to \$289,616.56?

A. That is right.

[fol. 3796] Q. State whether or not notice was also given to the receivers, or rather whether proof of claim was filed with the receivers, for additional taxes, that is, social security taxes in the amount of \$6,506.58?

A. That is right.

Q. Is the total claim for taxes filed by the federal government \$296,123.14, including interest up to some date in May, 1941?

A. Yes, and there is—there was an overpayment for one of those years which will bring the net tax down to approximately \$265,000.

Q. I will ask you to read this letter of May 27, 1941, and state whether or not you were in error in stating that that will bring it down.

The Court: Don't read it into the record.

Mr. Farmer: No, I am just refreshing him on it.

A. I am familiar with this. This increases it \$30,130.14—increases this amount on the face of the claim—but subsequent to this—and I don't seem to find it in the files—we have already filed that, but we can't get the refund until we pay the tax—pay the Internal Revenue Department—[fol. 3797] but it has held that there is \$30,000 refund due the association on some of the previous years, I don't recall which, making a net in the neighborhood of \$265,000.

Q. Does this letter of May 27, 1941, to the receivers state that the total amount of the tax, with the notice attached, was \$319,723.70, and then state that there was an over-assessment of \$29,911.25, which would bring the amount claimed down to \$289,616.56?

A. Yes, I am familiar with this, but I still state that there has been an overpayment which would bring the total down on the basis of this assessment to something in the neighborhood of \$265,000 from that amount there.

Q. Have you got any supplemental notices that will substantiate that?

A. I don't seem to find them in the file, but the application was made, as I understand, by Haskins & Sells representing the trustee in the case. In order to protect the claim it had to be filed within a certain time, and that has already been done.

Q. Well, I believe I will have to ask you to file this copy of this letter of May 27, 1941.

[fol. 3798] The Court: I sustain an objection to that. I don't think it has anything to do with this.

Mr. Farmer: Well, I would like to ask for the letters or communications that will prove that, then.

The Witness: I can't find them in the files. I searched for them. I just recall from memory that there was a refund due the company and proper application was made.

Q. You mean in addition to this over-assessment of \$29,911.25 that is mentioned in this letter?

A. Yes.

The Court: Mr. Farmer, if there were taxes of a million dollars claimed by the government, what bearing does that have on the case?

Mr. Farmer: If the Court please, the taxes, if they are liable for them, will be a preferred claim against the general assets of the estate, and I should say that a \$300,000 preferred claim out of the general assets would point out the much greater difficulty of bringing about a reorganization.

The Court: I don't think that has any bearing on the issues involved, whether this company is 10-per cent insolvent [fols. 3799-3806] or 10½ per cent insolvent, in my opinion, can make no difference in the prospects of this reorganization.

Mr. Farmer:

Q. Mr. Smith, that additional assessment or deficiency assessment was due primarily to the government agent investigating and including all of the income from the various reserve funds with the income account of the general fund.

A. That is right.

The Court: Mr. Farmer, I have told you that I do not regard that as having any bearing on the case, and I am not going to permit the record to be stuffed with it.

Mr. Farmer: Well, I would not have asked it if I didn't think it was relevant and some Court might differ with your Honor on it.

The Court: I am not going to permit it to go on the record any further.

Mr. Farmer: I except to your Honor's ruling. I would like to go on with the evidence on it.

[fols. 3807-3810] Mr. Eney: May I break in that point?

The Court: All right, Mr. Eney.

Mr. Eney: Your Honor held our motion should be heard at the close of the case, and I assume the purpose was that your Honor should consider all the evidence offered at this hearing in ruling on that motion. I want to have an understanding if that is the case.

The Court: That is correct.

Mr. Eney: All the evidence on this hearing is evidence on our motion?

The Court: Yes, that is correct.

[fols. 1-4] ARLEN G. SWIGER, called as a witness by the Trustee, having been duly sworn, testified as follows:

Direct examination.

By Mr. T. C. Townsend:

Q. Your name is Arlen G. Swiger?

A. That is right.

Q. Where is your residence?

A. New York City.

Q. What is your profession or business?

A. I am an attorney.

Q. Did you at one time practice law in West Virginia?

A. Yes, sir, I tried to.

Q. A native of this state?

A. Yes, sir.

Q. Did you ever hold any public position in this state?

A. Well, a very small one.

Q. What was it?

[fol. 5] A. A member of the legislature.

Q. Mr. Swiger, how long have you lived in New York City?

A. Since 1919.

Q. I hand you herewith a letter signed by you, dated September 24, 1941, and addressed to the Central Trust Company. I will ask you to inspect the letter and state whether or not you wrote the letter and signed the letter.

A. Yes, sir, I did.

Q. I will ask you further to examine what purports to be a copy of that letter attached to the petition filed in connection with the subject matter of that letter and state whether or not that is a true copy of the original letter.

A. Yes, sir, that is a copy of the original letter of September 24, 1941.

Mr. Farmer: If the Court please, I hate to ask this question, because I ought to have heard what the Court said about it, but I didn't. Is this a part of the record in this, or not?

Mr. T. C. Townsend: I will clear that up if you will [fol. 6] just let him put this testimony in.

Mr. Farmer: I didn't understand what the Court's ruling was.

The Court: It is to be heard as an independent proceeding, and then such parts of it as are pertinent to the questions involved in the general hearing, as I understand, will be offered as a part of the record by Mr. Townsend.

Mr. Farmer: Well then, we will have the liberty to offer other parts? Is that right?

The Court: That is right.

Mr. Townsend:

Q. Does this letter to which you refer contain the proposition of Pell, Ltd., with reference to buying the capital

stock of Fidel, a wholly-owned subsidiary of Fidelity Assurance Association?

A. Yes, sir, that is an offer on the part of Pell, Ltd.

Q. Are you familiar with the financial affairs of Pell, Ltd.?

A. Yes, sir.

Q. Are you in position to tell the Court whether or not [fol. 7] Pell, Ltd., is in a financial position to carry out and comply with this offer if it should be accepted?

A. Yes, sir, I will say that if this offer is accepted and in our opinion good delivery can be made of the stock, we will be prepared to accept and pay for the stock at that time in cash.

Q. In accordance with the terms of this letter?

A. Yes, sir.

Mr. T. C. Townsend: Your Honor, for the benefit of, or in response to a request made by an attorney representing one of the defendants here, I think it might be well for me just to read this letter so they will know its contents. It is short.

The Court: All right. There is no use to put it in the record. It is a part of the petition, isn't it?

Mr. T. C. Townsend: Yes. I don't mean to read it into the record.

(Mr. Townsend thereupon read the letter referred to to Court and counsel.)

Mr. T. C. Townsend:

Q. Mr. Swiger, in this offer made by you you refer to Fidelity Assurance Association to the effect that you are [fol. 8] prepared to give serious consideration to furnishing additional capital in connection with Fidelity Assurance Association if you are successful in acquiring Fidel, or the capital stock of Fidel. I wish you would explain to the Court, if you will, in your own way, what you mean by that statement.

A. A part of the directors of Pell, Ltd., are fairly well acquainted with Fidelity Investment Association. At least three years ago they made an examination into the financial affairs of Fidelity for the purpose at that time of reorganizing or investing new capital or both. At that time, at our own expense, we had Haskins and Sells prepare a special report for us on Fidelity. We had many conferences with

the executives of the company, and the negotiations had, I would say, reached a serious stage. Those negotiations were interrupted by litigation in which Fidelity was involved, and we naturally didn't continue with our efforts to reorganize or to acquire an interest in the company.

Now as to Fidel, in our examination of the affairs of Fidelity we naturally looked into the Fidel company, be- [fol. 9] cause it is a New York corporation. I think one of my associates organized Fidel, and I believe he drafted the indentures under which Fidel now operates, so we—that is, my own office and my associates as directors of Pell, Ltd.—were and are fairly well acquainted with Fidel.

As a result of this investigation, which has continued over a period of years, and of our recent investigation of the Fidel Company, we are making this offer for the Fidel stock. We are also interested in working on a plan of reorganization for Fidelity. Now, from our standpoint that is a difficult job. It involves a lot of considerations. We don't know what the situation will be in reference to Fidelity when this litigation ends. We don't know what the general business conditions in the country may be at the time that this litigation ends and the proper time comes for the filing of a plan of reorganization. However, we want to make this point clear: we don't want to base our purchase of the Fidel stock on a promise to finance and reorganize Fidelity. If we purchase the Fidelity stock, at our own expense—

[fol. 10] The Court: You mean Fidel.

A. Fidel. If we purchase the Fidel Stock, at our own expense we propose to make this study and examination of Fidelity and see if we can work out some feasible plan. We have in mind that it has value if it could be reorganized and operated in a manner which would meet with the approval of the Securities and Exchange Commission and various other government and state agencies which might look into it.

Mr. T. C. Townsend:

Q. Let me see if I understand just exactly what you mean by your answer. If you are successful in acquiring the capital stock of Fidel, then, as I understand you, it is your purpose to make an investigation of the affairs of Fidelity to the extent of determining whether or not you shall, in con-

nection with these proceedings and at a later date, file or suggest a plan of reorganization?

A. Our group is seriously interested in working out a plan of reorganization for Fidelity.

Q. And of course whatever you did in that connection you would do at your own expense.

A. Yes.

[fol. 11] The Court: Let me ask Mr. Swiger a question in order to fully understand what he means. Do I understand that the consideration which you will give, as you say in your letter there, to the refinancing of Fidelity—does that contemplate that your group would, at the proper time if you determine that you want to go ahead, put in the money for a capital structure of a new or reorganized company, and that that money would come through Fidel?

A. I will answer that question this way, if I may. I don't think that money would come through Fidel. I think it might be new money. I couldn't naturally, say what form our plan or reorganization would take, but it would certainly require some additional money, which we would be prepared to furnish as a part of that plan. I see no way now by which the funds of Fidel could be used for that purpose, and there would be no desire on our part to use Fidel money for that purpose.

Q. What I meant was, would it through Fidel, by making your investment in Fidel and then having Fidel to put up the capital structure contemplated.

[fol. 12] A. It is quite possible that the order of Fidel and Fidelity might be reversed, and it might be possible, from our study of the situation, to make Fidel the top company and Fidelity the subsidiary. That might be worked out.

Q. Whatever you have in mind involves the creation of a capital structure which would be actually invested by your group, and does not contemplate simply a promotion whereby you would take that matter of getting the capital together to the general public in a sales campaign of any kind, does it?

A. We are not interested in attempting to revive Fidelity as such and to continue along the same plan it has been operated in the past. It is our judgment that something radical has to be done, probably a new plan. Probably it must have something new to sell that is a little different from what it has been selling.

Q. What I was more interested in in connection with the capital that may be put into a reorganized company, I want to know whether it is the idea that that capital stock be got together by any sort of promotion work with the general [fol. 13] public, or is it the idea that that will be capital advanced by your group of investors?

A. I would say that any plan of reorganization which we would offer to the court which involved new capital will be capital raised by our group. We don't anticipate selling securities to the public.

The Court: All right. That is what I wanted to know.

Mr. T. C. Townsend:

Q. Just following up the question asked by His Honor, there is appended to this petition filed here a list of the directors of Pell, Ltd., quite a long list. Are you acquainted with these directors?

A. Yes, I know all of them.

Q. Do you know something about their financial responsibility?

A. Well, it is difficult these days, Tom, to know anything about people's financial responsibilities, but I will say this: they are all successful in their particular lines of business; they are considered men of good judgment and experience, men who meet their obligations.

[fol. 14] Q. Well, let's assume you became interested in Fidelity to the extent of venturing a plan of reorganization, and you could interest in Fidelity the same people who are listed as directors of Pell, Ltd., from that source do you feel that you could acquire the additional capital necessary to refinance Fidelity?

A. Well, we are of the opinion that it is easier to get the money than it is to get the management.

Q. Then you feel that you can get the money if you can get the management?

A. Yes, sir.

Q. And in your group do you feel that you could get both management and money?

A. Yes, if it holds a chance of reasonable compensation for those who invest their money in it. And I mean to qualify that by saying, there is no one in this group that is looking for salaries, nor are they looking for quick profits, but

they would hope to build this up so that eventually they would have something worthwhile.

Q. When you say "build this up", that answer relates [fol. 15] to both Fidel and Fidelity?

A. Yes, it does. I might also add that as far as Fidel is concerned, from our group we have designated three directors who would be the directors of Fidel if we were acquiring the stock. Those are Mr. Pell, Mr. Cecil Stewart and Mr. Rosenblatt. Those three would act as the officers and directors of Fidel without compensation.

Q. You stated that your group would not be looking for quick profits. Would you care to expand that a little and state over what period of years you would expect to act?

A. Well, of course, these plans are only tentative, and to this time there has been much discussion but nothing definite; but it is the idea of this group of men that is a situation out of which little or no profit should be taken for a period of probably eight or ten years.

Mr. T. C. Townsend: I think that is all I want to ask this witness.

The Court:

Q. Mr. Swiger, I would like to inquire this of you. Your group understands, does it not, that at present the question [fol. 16] of the jurisdiction of the federal court to entertain this reorganization petition is in question here, that there is a hearing going on to determine that question of jurisdiction, and that it may be some time before that is determined? What I want to ask you is this: if that question of jurisdiction is not determined by the time this offer runs out, is there any expectation of a renewal or extension of time in connection with the offer?

A. Well, I want to make this clear. I am not coming here on behalf of this group of men to wage any fight for the stock of Fidel. If there is serious opposition to it, we don't want it. We don't propose to be involved in any controversy whatever. I think there is a situation that should be given consideration. I understand that a number of contract holders of Fidel have turned in their contracts for cash. I think that amount is about \$600,000 since the first of July. Now, that raises the question as to whether that is going to continue or whether it may slow up. If it continues the corporation will in effect be liqui-

dated by the contract holders, and there will not be much [fol. 17] left. If we acquired the stock we would hope to take some action to stop that, if we could. I will discuss with my clients the question raised by the Court about October 19th. I am inclined to think that if for some reason action is not taken on this matter at the time mentioned in the offer, that we will continue this offer, provided there is no radical change in Fidel. We don't want to precipitate this matter at all; we don't want to hurry anybody about it.

Q. Your offer itself contains the condition that you must be satisfied with the authority to deliver. I assume that you will not be satisfied of that until you know whether or not this Court has jurisdiction to authorize it?

A. There is a serious question in our minds just how we can get good title to the stock. We probably will have to engage most of counsel sitting around the court here to tell us the answer to that question.

The Court: All right. Does anyone wish to cross-examine Mr. Swiger?

Mr. T. C. Townsend: I am sure those counsel around the table can never agree on it.

[fol. 18] Cross-examination.

By Mr. Palmer:

Q. Mr. Swiger, for the purposes of this record, which may or may not become a part of the record of the other case, I would like to ask you some questions. Is Pell, Ltd., a corporation?

A. Yes, sir, a Delaware corporation.

Q. And would you mind stating into the record the type of business engaged in by Pell, Ltd?

A. Pell, Ltd. maintains an office at 60 East Forty-Second Street, New York, and its directors meet rather frequently for the purpose of discussing new and old business matters which may come to its attention. It might be a reorganization, it might be the sale of a utility in Central America, it might be a new process of making a chemical or some other matter which is of interest to this group of men.

Q. Do I understand by that that this group of men supply capital, money, to various enterprises?

A. Only to their own enterprises. If something is called to their attention and they think it is worthwhile financing

and managing, they provide the finances, sometimes within [fol. 19] their own group and sometimes they will invite someone from the outside to come in and furnish a part of the capital.

Q. May I ask the capital structure of Pell, Ltd., that is, financially?

A. I should know that, but I don't, but I can say this to you. Pell, Ltd., had fifty thousand dollars not long ago in its treasury. It pays no salaries. The only employee is a secretary, a young lady. Its only other expense is the rent for the office and stationery and telephone calls and so forth; and it was never intended that the money of Pell, Ltd., itself would be used for these various matters, but if this group of men, after much discussion and much talk pro and con, decided that it was to their interest to go into a proposition, then they themselves with their associates would furnish the capital.

Q. Do you do in any sense of the word a brokerage business?

A. In no sense a brokerage business.

Q. Do you sell issues of stock to the public?

A. No sale of securities at all.

[fol. 20] Q. Am I to understand that this is more or less a partnership, but however, in a corporate form, whereby the gentlemen who are engaged in it, if a project is interesting to them, will go into that project, individually or as a group, and do what they feel is necessary in connection therewith?

A. Well, it does in many respects have the form of a partnership, although it is a corporation. I think all the stock of the corporation is owned by the directors, and naturally we consider many propositions. Most of them are turned down; we consider them bad and we don't enter into the particular matters pending before us.

Q. Let me ask you this. Suppose the Court would approve this proposition. At the present time, from what you have told us, there would not be enough cash in Pell, Ltd., to pay for it? Is that correct?

A. Yes, sir. There never is enough cash in Pell, Ltd. to pay for the propositions that we may enter into.

Q. That was my understanding. However, if the board of directors determines to go into it, then they advance

[fol. 21] money into the treasury of Pell, Ltd., or what is the procedure?

A. Well, the procedure is rather a practical one. We know each other very well. We know where the money is coming from and in what amount; and probably if we worked out all the problems in connection with the purchase of this security, and I was advised that it was to be delivered in Charleston on Tuesday against cash, probably on Saturday or Monday I would call my associates on the phone and get the money and be here with the cash or a certified check.

Q. The point I am getting at is, however, that in the event the court should permit such a contract to be entered into by the trustee and Pell, Ltd. would later, after entering into the contract, for any reason whatsoever be unable or unwilling to carry it through, there would be no corporate liability to which the trustee could look for a breach of that contract.

Mr. Hillis Townsend: I don't know that there has been any proposal here to enter into a contract.

Mr. Palmer: Contract for sale of the stock.

Mr. Hillis Townsend: There isn't any—

[fol. 22] A. We don't expect to have the stock delivered to us until we pay for it.

Mr. Palmer: That was my understanding, but what I am trying to find out is this, sir, and I am only asking for the information of the record and the Court. Pell, Ltd. itself, as you have told us, has so much capital.

A. Yes, sir.

Q. The contract for the sale of the stock, or the acceptance of the offer made, would be made with Pell, Ltd., a corporation. If Pell, Ltd. were unable or unwilling to carry it through, the only liability to which the trustee could look would be the assets of Pell, Ltd.? Isn't that correct?

A. From a legal standpoint that is correct. However, you have coupled with that the integrity of a substantial group of men who I do not believe would negotiate on that basis with this Court.

Q. I understand that, and I am attempting to get the legal situation into the record here. Now, also, if Pell, Ltd. should buy this and there should be mismanagement—I am

[fol. 23] not suggesting that there would be, but if there should be, by Pell, Ltd.—the only ones to whom the contract holders could look would be to the corporate liability of Pell, Ltd., and not to the individuals? Isn't that true as a legal situation?

A: I would think not. I would think if Messrs. Pell, Stéwart and Rosenblatt become directors and officers of Fidel, I think they would be personally responsible for mismanagement.

Q. But the owners of the stock would, of course, again be Pell, Ltd.—is that correct—or would the stock be distributed among the directors of Pell, Ltd. individually?

A. Although the details of that are not worked out, I would think that the stock would be distributed, part of it going to directors and part of it to Pell, Ltd.; maybe some to one or two associates.

Q. Would it be fair to say that Pell, Ltd. is a holding company, or in this company would act as a holding company of the stock of Fidel?

A. No, it would not. I would say the arrangement would be rather a simple one; probably five, eight or ten people would provide the money. Pell, Ltd. would acquire the [fols. 24-32] stock, and at a later date it would transfer part of the stock to those who had provided the cash.

Q. In furtherance of the Court's question, would any of that be offered to the public generally or to certain individuals of the public whom you term associates, or are they already predetermined?

A. If there is anything I want to be positive about it is that there is going to be no public offering in connection with our negotiations in reference to Fidel or Fidelity.

[fol. 33] Mr. Palmer: Your Honor, I am not too familiar with these proceedings myself, and I am asking Mr. Swiger to help me on it, but my understanding is this, that in each Series B. Contract it is provided that the profits made by or through the lapsation and cash surrenders—we have discovered that Fidelity makes the same kind of profits—are kept in that series fund, and half of the profit on that goes to those contract holders who mature their contracts and half of it goes to the company. Now, if all of the contract holders lapse and cash surrender their contracts

before maturity, then the company would get the whole of that profit.

The Court: You mean if they do that after these people take hold?

Mr. Palmer: Yes, that is what I am asking, and I think that can be done, although I don't know. As I say, Mr. [fol. 34] Swiger has studied this company and I have not, and I am asking his advice and opinion on that particular problem.

The Witness: Our minds have run along the other angle. We are somewhat disturbed because the contract holders are turning them back for liquidation, and we have not looked at it from the standpoint—your standpoint, Mr. Palmer.

The Court: You wouldn't expect, Mr. Palmer, that any prospective purchaser would be willing to pay some extra consideration on the possibility that there would be contracts lapsed or surrendered out of which they might derive a profit, would you?

Mr. Palmer: Yes, I would, Your Honor. That is just what the Court was asking one of the witnesses to consider yesterday, that experience had shown with these companies that that was what happened time after time and that was a legitimate source of profit to the company.

The Court: Yes, of profit, but not of present value.

Mr. Palmer: If that is the normal experience and it is [fol. 35] shown that that will be made and turned into a profit, all things being equal there should be some payment made for that.

The Witness: Well, I want to state for the purpose of the record that I think all interested parties should give serious consideration to our offer, and it may be possible that somebody will make a better offer. I will not be disturbed if they do; and I want all parties interested to feel that our offer is a fair and reasonable one and it is the best offer that you can obtain at this time, otherwise we would not want to buy this stock.

Mr. Palmer:

Q. Mr. Swiger, may I ask this? Is it your plan to issue new certificates and sell them, such as Fidel had issued in the past?

A. Mr. Palmer, that question will not be decided until we have purchased the stock and have our money invested,

and we will probably leave it alone as it is for a short period of time and make a very careful study of what we can do about it.

Q. Mr. Swiger, answer me this. Suppose that I am a contract holder of Fidel and I hear of this offer of yours. [fol. 36] Would you show me where I am going to be benefited by your purchasing that stock?

A. Well, perhaps you might be pleased with the new management.

Q. Well, is that the only thing that you have to offer to the contract holders of Fidel, a new group of men to manage it for them?

A. I understand that their rights are pretty clearly defined in the contracts which they own and have bought and paid for, and I don't see anything we can do for them that would help their position more than to honestly, and I hope ably, administer the affairs of the corporation.

Q. You would have control of how many million dollars of funds for investment purposes?

A. I can't give you that figure. It is in the statement here. Whatever is there we would have control of.

(Mr. Palmer hands paper to witness.)

The Witness: I have to leave the hotel at 2:50. I can't miss that plane.

The Court: I think we ought to get through with him [fols. 37-41] then.

[fol. 42] JOSEPH R. KELLEY called as a witness by the Trustee, having been duly sworn, testified as follows:

Direct examination.

By Mr. T. C. Townsend:

Q. Will you please state your name?

A. Joseph R. Kelley.

Q. Where do you live?

A. 21 Allison Avenue, Yonkers, Westchester County, New York.

Q. What is your business?

A. I am attorney and counsellor at law of the State of New York.

Q. With offices in New York City?

A. 60 East 42d Street and at 120 Broadway, New York City.

Q. Were you ever at any time connected with S. E. C.?

A. For a period of months in the early part of 1939 I was temporarily connected with the Securities and Exchange Commission, Monopoly Study Division, part of the time as special counsel in one of the sections and part of the time as financial adviser in the same section of that [fol. 43-44] division.

Q. Are you connected with Fidel corporation in any respect?

A. At the present time I am a director of Fidel Association of New York, Incorporated; and for a period of years past, since the date of its incorporation, I have acted from time to time as special counsel to it, particularly in matters relating to the various indentures under which its collateral trust bonds are issued.

[fol. 45] Q. Will you tell the Court why, in your opinion, it should be accepted?

A. The principal reason for my opinion is that I look upon Fidel as practically a wasting asset corporation, in this sense of the word. While Fidel was in the market selling or offering for sale its collateral trust bonds, it was replenishing its life stream of new income, so to speak; but since it discontinued selling new bonds it has all of the burdens of management of the collateral trust funds, it has to maintain offices within the State of New York and within the City of New York to receive subscription installments from bondholders and to pay to bondholders what [fol. 46] the bondholders are entitled to receive under the terms of their bonds; and that necessarily means, in turn, that Fidel Association has to keep at New York an agent or officer having at least some executive powers and functions; it must have the services of a consulting actuary at all times; and from time to time it has needed the services of a special counsel—by which I mean myself—because of problems that have arisen under the indentures, the latest of which, of course, was the necessity of finding a successor or substitute trustee within the City of New York to act

in place of the Charleston National Bank, which desired to retire from the business.

Now, while the several bondholders continue to pay in their monthly or periodic subscriptions, it is my understanding that the gross income of Fidel will be sufficient to pay all of the costs of management and the fees of consulting actuaries, and counsel and so forth; but little by little, as bondholders either permit their subscriptions to lapse or avail themselves of their cash surrender privilege, or borrow on the amount of the bond and then decide not to pay it back, it necessarily means that the income of Fidel is a [fol. 47] constantly diminishing thing. Furthermore, even if every holder of bonds continued to pay his subscription price, there will come a time in the future when the last bondholder will have paid the last installment and there will be no new income to Fidel from that source then, but there will be perhaps ten years of management ahead of it, and that management, I need hardly add, is almost a sacred trust, because this Fidel scheme comes very, very close to being an unofficial savings bank. They have a couple of million dollars there which represent the savings of several thousand people, most of whom are either poor people, or, to say the least, people who have to save, if they are going to save at all, in small amounts. The management of the trust is going to be supervised; there is no question about that. The Investment Company Division of Securities and Exchange Commission has a certain supervisory and regulatory jurisdiction in the matter, and the New York State Attorney General likewise has a certain supervisory jurisdiction; and that supervision and regulation takes time and money to comply with; it again requires the retention of counsel and consulting actuaries. That is why I say this Fidel looks to me like a wasting asset proposition [fol. 48] as of the date when it had to stop selling, or did stop selling, bonds; and therefore I think this offer to buy it at what is defined in the offer as its liquidating value is a favorable offer from the point of view of Fidelity and its trustee and receivers, and therefore, in my opinion, it should be accepted.

Q. How much, in your opinion, would be realized from this offer?

A. In answering that question I am basing my opinion on the last statement of Fidel Association that I have seen.

which is as of June 30, 1941. In my opinion the amount realized on the sale of Fidel stock should be in the neighborhood of \$125,000—perhaps a bit more. As I understand it, the liquidating value is to be determined by Haskins & Sells as of the date when the stock passes and the money is to be tendered for the stock; and of course three months have already elapsed since that June 30, 1941, determination date; but assuming that it is anything near the same that should be the price, in my opinion.

Q. What date did Fidel cease selling contracts in the State of New York?

[fol. 49] A. I have that only on information supplied by Mr. Young, Mr. Townsend, and I think it was as of the first of the year, but it may have been as of the first of December 1940; I am not sure. I may add that it had ceased selling for a considerable time before I found out that it had ceased to sell them.

The Court:

Q. Mr. Kelley, if Fidel is a wasting asset in the hands of Fidelity, is it also a wasting asset in the hands of a purchaser or prospective purchaser?

A. It is my honest opinion that that is exactly what it is going to turn out to be.

Q. Then do you know of any reason why the offer is being made?

A. I couldn't say, your Honor, that I know. I have heard certain discussions in connection with it, largely as pure conversation, which have led me to believe that there have been a number of groups of financiers in New York City who seem to think that if they acquire control of the stock of Fidel and thereby acquire control of its board of directors and thereby acquire control, within the framework of the indentures, of the collateral trust funds, that [fol. 50] with their superior knowledge of security values, market conditions, and so forth, that they could so invest and reinvest the collateral trust funds that both the bondholders and Fidel would benefit by virtue of the provisions in the several indentures which permit a division of the excess accumulations in the collateral trust funds as between the bondholders as a class and the corporation, as of the semiannual-determination dates fixed in the indentures. Your Honor, I cannot say as a fact that that is the intention of anyone. It is my belief from conversations

that I have heard incidentally over quite a period of time that that idea has been played with by more than one group of financiers; and it is quite possible that either Pell, Ltd. or the people with whom Pell, Ltd. may be associated in this deal, if they bring associates in, have something of the same idea; but, sir, that would not affect the opinion that I have already expressed that it is a wasting asset proposition and it is going to be that even in the hands of financiers, although I say that with due deference to their superior knowledge.

Q. If it were left in the hands of Fidelity, Fidelity would participate in the 50 per cent of those excess surpluses, or [fol. 51] whatever it was you called them, instead of the prospective purchaser?

A. That is correct.

Q. Do you have any idea what that would amount to?

A. I have not, your Honor. The only information I have on that point is information supplied to me by Mr. Young several months ago; and he told me at that time that the state of the account as between Fidel Association and the several collateral trust funds was such that there would be no more excess accumulations in the collateral trust funds in which Fidel could participate until something like thirty-eight or forty thousand dollars had been made up in that fund to equalize the credit to which the bondholders were entitled. Mr. Young has also told me—and here again I cannot express any opinion as to the fact myself—that during the years when Fidelity managed Fidel, Fidelity was never inclined to permit free trading, so to speak—investing, selling, reinvesting in the collateral trust fund for the purpose of making a profit. I might also add, your Honor, that I don't think that either the Federal Securities and Exchange Commission nor the State Attorney General [fol. 52] is going to look with favor on any scheme or plan on the part of anyone, no matter how honest it is, to do anything with those collateral trust funds except keep them invested in pretty high-grade things, and once having found high-grade things in which to invest to leave it that way, just to the extent that they have power to supervise and regulate under the circumstances. Again I revert to the thought of practically an unofficial savings bank; you have a fund that does not lend itself to playing with it, if I may use the expression.

Q. Is it your opinion from your knowledge and observation that this offer of the liquidating value is the best offer that can be obtained at this time from any source?

A. Yes, your Honor, I can answer that without qualification or hesitation. I honestly believe it is by far the best offer that can be obtained from any source. I might add in connection with that, your Honor, that there are other factors operative in the case of Fidel that, in my judgment, make it difficult to sell. Fidel was organized for the sole purpose of getting around statutory provisions in the law [fol. 53] of New York that prevented Fidelity from coming into New York on its own and doing business in New York, because Fidelity was and is, according to the banking law of New York, an investment company, and an investment company can't get into New York, be it domestic or foreign, without the permission of the Superintendent of Banks, and the Superintendent of Banks of the State of New York had years ago informally refused permission to let Fidelity in, on two grounds, the first was that he did not have the man power to supervise or regulate investment companies the way they should be, particularly those that were writing cumulative investment certificates of the kind Fidelity was offering, and, secondly, that Fidelity and companies like it came too much in competition with savings banks and savings and loan associations organized under the New York banking law, which offered a comparable service to investors without any load for sales expense.

Anyway, Fidelity couldn't get into New York; and when I was first retained by Fidelity it was for the purpose of seeing whether or not some way could be found to let Fidelity into New York. I tried to get it through the Insurance Department of the State first, and I couldn't, because [fol. 54] it wasn't issuing any contract that had an insurable hazard in it, it was not an insurance company in New York. But there had been a 1929 amendment to the stock corporation law of New York, which controls the organization of ordinary business corporations, which provided that you could form, under the stock corporation law, a company for the purpose of acquiring the bonds, notes and choses in action of other persons, firms or corporations and issuing collateral trust bonds against the security thereof; and while it is pretty obvious that that statute was not intended to permit Fidelity to get into New

York and do indirectly what the banking law prohibited it from doing directly, none the less the State Attorney General rendered, in 1932 I think it was, an opinion approving as being within the law the Fidel setup.

That arrangement was never acquiesced in—that opinion, rather, was never acquiesced in—by the Superintendent of Banks of New York, so that the way the thing stands at the moment, the Superintendent of Banks feels that Fidel does not conform to the statute, the Attorney General is on record with an opinion that it does, and there has never [fol. 55] been a determination as to whether it does or does not. When those facts, you see, are inquired into by any prospective purchaser, the tendency might be to scare them off, because even though Fidel doesn't offer bonds any more, there are provisions under the general business law of New York whereby the State Attorney General could, should he change his mind and become convinced that Fidel was an illegal method of doing business, move for the appointment of what is known in New York as a Martin Act receiver, which would simply take possession of all the assets, liquidate them, and put Fidel out of business, and whoever paid anywhere from a hundred to a hundred and twenty-five thousand for its capital stock would get nothing; the expenses of the liquidation unquestionably would eat up any equity it had.

It is for those reasons that I myself feel from the point of view of Fidel and Fidelity that this is a good offer and, frankly, should be grabbed at.

The Court: Anything else?

Mr. T. C. Townsend: We have nothing, your Honor.

Cross-examination.

By Mr. Palmer:

Q. Mr. Kelley, for what purposes are a consulting actuary needed?

[fol. 56] A. Under the indenture it is on the certificate of the consulting actuary furnished to the trustee from time to time, I think semiannually, that the amount of the required accumulations—in other words, the actuarial reserves—are determined. That becomes the first factor in your equation. Twice a year the trustee receives from the consulting actuary, who must be an independent actuary, although he

may be selected by the company, a certification in which the consulting actuary advises the trustee as to the amount which should be in the collateral trust funds as a reserve for the protection of these bonds as they mature. Then values are ascertained in accordance with formulae set forth in some detail in the indenture and the two figures are compared; and it is by a comparison of the actuarial certification with the indenture appraisement that the trustee may know from time to time whether the collateral trust funds are adequate or whether they are in default to any extent.

Then the next job of the consulting actuary is to make the computations that are required from time to time to determine whether or not there are excess accumulations [fol. 57] in the reserves for division and allocation as between the bondholders as a class and the corporation; and in that connection I might point out that there is a little complication comes in there. When you value the collateral trust securities to determine whether or not the collateral trust fund is adequate in the light of the actuarial figure which has been certified by the actuary, you do not take—here at least—market value into consideration at all. You see, if you have securities in there that are not in default as to principal or interest and are otherwise in good standing, then you can return them at par; whereas when you come to the computation that has to do with the allocation of—no, let's not say allocation—has to do with the determination of whether or not there is an excess accumulation in the collateral trust fund, you shift your base, and you do not use the indenture formulae, but you use market or cost, whichever is lower, or, if there is not any market, book or cost, whichever is lower.

So you see that semiannually you have those three factors that have to be ascertained: (a) the amount of actuarial reserve required; (b) the values per indenture formulae; [fol. 58] and (c) values for determination of excess earnings or excess accumulations in the collateral trust funds.

Then there is another function that the consulting actuary has—

Q. Will you pardon me just a second before you go into that next feature?

A. Yes.

Q. The third one, which provides for division between contract holders and owners of stock, is based upon market value? Is that correct?

A. Market or cost, whichever is lower. At least, that is my unaided recollection of the provisions of the indenture.

Q. Now go ahead. I didn't want to interrupt you.

A. Now, there is a fourth job that a consulting actuary has to do within the framework of the indentures themselves, and that is that as the holders of bonds complete their subscription payments and the bonds become due, then a point of time is reached with respect to that particular bondholder when his right to share in that excess is no longer [fol. 59] provisional, it is definitive and absolute; and then there is another special formula in the indenture for the use of the actuary in working out the ratios and to the last penny the share in that accumulation that that particular bondholder should have.

Then the other respect in which I know that the services of a consulting actuary are needed is that, ordinarily at least, when you want to explain this scheme to anybody, you have to have an actuary, because there is a point beyond which I can't take you. I know the legal aspect of it fairly well, because I drew the indentures, but I would not even attempt to express an opinion about the actuarial complications of it, because I don't know.

I might add, too, of course if there is ever occasion to put out new indentures—and that seems to be out of the question now—you obviously need one then; he has to collaborate with you in getting the indenture.

Q. Mr. Kelley, at the end of any semiannual period, as I understand it, on market value there is determined whether or not there is an excess in the fund, and if there is an excess 50 per cent of it goes to the general or stockholders' fund and 50 per cent is retained in the fund for the benefit of [fol. 60] the contract holders. Am I correct in that?

A. It is correct with this one qualification. There is a further provision in the indentures which limits the right of Fidel to participate in that fund under certain circumstances. If you care to, I have that stuff here, and I will be glad to read to you that particular sentence which embodies that qualification.

Q. All right, sir.

A (Reading): "Provided, however, that the aggregate share of such excess credited to the account of the Association at any time shall not be increased by current allotment upon any determination date to an amount greater

than the aggregate share of such excess provisionally credited to the account of the registered holders of such bonds as a class at the same time."

Q. What does that mean, Mr. Kelley?

A. I might say in the beginning that that was the language of the actuary, not the lawyer; but it is my understanding that that means this. If, on a given determination date, let us say January 1 in any year, it appears that the bondholders provisionally are entitled to x dollars and Fidel is entitled [fol. 61] to and takes x dollars, and in the ensuing six months something happens to the market value of the collateral trust fund, that the provisional credit for the benefit of the bondholders is either wiped out or diminished. Then Fidel can participate in the second ensuing determination date only after what the provisional credit for the bondholders lost in the first six months of the period has been made up in the second.

Now, that is my understanding. I can only say that is what I thought it meant when it was incorporated in the indenture; and my later discussions with Mr. Young have led me to believe that that also is his understanding of it. Otherwise, you see, it would be impossible to explain the fact that Fidel can't participate in this excess for some period of time to come until the provisional credit for the bondholders has been built up to the extent that he told me of \$38,000.

Q. The legal interpretation of that key sentence would be on the determination whether or not anyone who bought it out could continually draw out their profits, even though the bondholders might not be getting a profit? In other words—

A. Yes, that is my understanding exactly.

[fol. 62] Q. And if your understanding of that key sentence would be wrong and it would be interpreted otherwise, then the stockholders could make a profit more or less even though the bondholders were losing money?

A. Oh, sure. In effect, then, you would be perpetrating a fraud on the public, because in my opinion you would have no right to take the money of the public without advising them in writing exactly the way you were going to run that fund and then let them buy it if they want to.

Q. But if the person who bought this out should obtain a legal decision that the interpretation you have given us is not correct and that they could continue to take out profits,

then it would be a very advantageous thing for anyone who bought the stock of Fidel, wouldn't it?

A. Yes, but, again, there are qualifications to that, because, to begin with, the indenture trustee; whether it has the right under the indenture or not, has certain ideas of its own as to how these funds should be managed, and of course the indenture trustee is the one who has this property. If [fol. 63] the indenture trustee is not satisfied that the administration of the fund is in accordance with its construction of the indenture, it wouldn't do anyone a great deal of good to try to do something which they thought would be more advantageous to them, because the indenture trustee has too many powers. The indenture trustee would unquestionably under those circumstances apply to a New York court for instructions to determine the question. I haven't the slightest doubt that there would be both state and federal agencies who might interest themselves in it; and I honestly think it is impossible for anyone to make money for himself on the operation of these collateral trust funds, irrespective of any opinion of counsel you may get about the contract; there are too many people in existence to stop them; whether they have the right to or not they will.

Q. What would prevent the new stockholders from getting a new indenture trustee who might be more to their own liking?

A. Well, theoretically, nothing. Actually there always has been serious difficulty in getting indenture trustees in New York City to act under these indentures for a variety of reasons. Back in 1932, when the first of these indentures [fol. 64] was written, Fidelity tried to interest three or four trust companies in New York City of different sizes in the trusteeship, and the trust companies uniformly refused. Their reasons ran something like this: "We never saw anything like this indenture before, and have never been in this particular type of kind of business, and no matter what the State Attorney General says we are not sure about its validity or legality; and, secondly, we don't like to get into this installment contract business anyway; we are not geared for it;" and, finally, this scheme does unquestionably, you see, some directly into competition with the business of savings banks and savings and loan associations and the thrift departments of commercial banks, and for that reason, if for none other, it was not favored.

Anyway, we couldn't get a trustee in New York if we wanted to, and, fortunately, the Charleston National Bank examined into the business and found it acceptable and carried on for a number of years. Then, when it seemed desirable again to get the thing back in New York State, at the urging of state officials and others, Mr. Young was able to persuade the president of the Colonial Trust Company, [fol. 65] which is quite a small institution, to accept the business. The business was duly accepted, but it is far from easy to get a new trust company to take on a type of business of this kind, with which it is wholly unfamiliar, over and above all of which it is rather expensive, because, you see, every time you shift your trustee you have to pay a new acceptance fee to the trustee, you have to pay the fees of trustee's counsel, a lot of documents have to be prepared—It is quite a job, and there is plenty in it to discourage anyone that would try it, although theoretically there is nothing to stop them.

Q. Mr. Kelley, did I understand you to say that Mr. Young had told you that the Charleston Trust Company, when it was trustee, would not permit the manipulation of the securities in the portfolio for the purpose of trying to make a profit by buying and selling them?

The Court: Charleston National Bank.

Mr. Palmer: Yes; it was the trustee.

A. If I said the Charleston National Bank in that relation I was in error. I don't think I did. What I meant to say, and what I think I did say, is that Mr. Young has advised [fol. 66] me from time to time that Fidelity would not permit the free investment and reinvestment there; unless it got good security in the collateral trust fund it wanted to freeze it there.

Q. And it came out solvent by doing that?

A. I am convinced that Fidel is comfortably solvent and I am also convinced that the conservative investment policy had a lot to do with it.

Q. Now, these gentlemen who want to purchase it, it is your understanding, would like to do what Fidelity would not permit to be done, buy and sell and exchange the securities in the hope of making a profit by manipulation whereby they can buy at one price and sell at a different price?

A. Well, I couldn't say that that was my understanding with respect to Pell, Ltd. specifically or about any specific

group that might become associated with them. All that I can say in that connection is that over a considerable period of years I have heard conversation and discussions about the possibility of doing that. Of course, whenever I did hear it discussed, the point was always made by someone, [fol. 67] and I think rightly, that no one can make money out of the investment and reinvestment of that collateral trust fund over any period of time without making it for the benefit of the bondholders as well, because to the extent that it is made it means that you have an excess accumulation in the reserve from time to time in which Fidel and the bondholders share equally, the difference being that Fidel takes it out, whereas it provisionally remains in there for the bondholders, and the individual bondholder gets his share only as, if and when he completes his subscription payments.

Q. The \$125,000 approximately that would be paid for the stock, would that include any of the undivided profits which existed at the time of the sale in the funds?

A. Well, it would certainly be my understanding that it would, if such existed. It is, however, my understanding that none such exists, and I paid no further attention to it for that reason. It is not there, so I have not paid any further attention to whether it would pass it.

Q. The person who paid \$125,000 for it would have ample security for his \$125,000 by buying it at liquidating values? Isn't that correct?

A. Well, I think so, if my understanding of the nature of [fol. 68] the securities in which Fidel funds are invested is correct. I understand that they are conservative and reasonably high-grade securities, and barring some sort of financial debacle that would upset the whole nation I suppose that anyone who buys at liquidating value will certainly have reasonable security, subject always to this point, however, that as the years go on, unless he is able to make money either out of investment and reinvestment of the general fund or the investment and reinvestment of the collateral trust fund, or both, he is going to suffer from this wasting asset situation that I referred to earlier in my testimony.

Now, of course I realize I am under oath, and I am projecting myself into the future; I am expressing opinions. That is the way it strikes me.

Q. Mr. Kelley, it amounts to this, does it not: A group put up \$125,000 which at the present time would be adequately secured, and with that, because they put up \$125,000 which is perfectly secured to them, they are given two million dollars of someone else's money with which to gamble and hope to make money; the most they have to lose is [fol. 69] \$125,000, and if they are successful in the years of gambling with other people's money, then they can make a very comfortable profit for themselves and those other people equally?

A. Of course, they do have to operate within the framework of the indenture. That being so, I don't know whether "gambling" is the word. You see, these indentures are not set up to permit of the inclusion in the collateral trust funds of common or preferred stocks, so that takes a couple of the choicest vehicles for gambling right out of the operation to begin with. You see, you are dealing with bonds, notes, and, for want of a better term, choses in action, because that is the term used by the New York stock corporation law, but I have from time to time definitely rendered opinions to Fidel and to others connected with it that, as used in the statute and as used in these indentures, the term "choses in action" does not include common or preferred stocks, guaranteed or otherwise.

Q. Mr. Kelley, whether you call it gambling or not, the only purpose that anyone could want to do this would be for the purpose of buying some form of securities low and selling them high and thereby making a profit which they would share equally with the contract holders? Isn't that [fol. 70] true?

A. For the immediate future that would not necessarily be true, because for the immediate future a person who took over Fidel now might reasonably expect to have the benefit of continued subscription payments by the holders of bonds; but you do reach a point in the future—and I honestly can't tell you how far distant that point looks to me at the moment; I don't know, but it is there—you do reach a point in the future where the income to which the general fund of Fidel would be entitled out of the periodic subscription payments would in all probability be insufficient to pay the expense of maintaining and managing Fidel and the collateral trust funds; so that it does seem to me that over the long term—over the long view here—the only

chance that anyone has of making money out of a purchase of Fidel would be a pretty skillful operation of investing and reinvesting the collateral trust funds. I say it must be skillful because one mistake of a serious nature would have the enterprise insolvent at the next determination date, whereupon, of course, the indenture trustee would proceed immediately to liquidate immediately, either under the powers [fols. 71-76] reserved in the indenture or by application to a court for the appointment of a receiver.

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[fol. 77] Q. Well, if, over a period of years, the contract holders cash-surrender their contracts, there is a theoretical or book profit set up in the fund by virtue of the difference between the reserve and the cash surrender value? That is correct, isn't it?

A. I think that is correct, Mr. Farmer.

Q. I am Mr. Palmer. Mr. Farmer is over here.

A. Oh, I am sorry. I think that is correct if the liquidation of those bonds by the several bondholders is done over a period of years and not as part and parcel of a general liquidation as of a given moment of time.

Q. If it is done over a period of years, so that every contract holder cash-surrenders, then the stockholders not only get the entire fund, because there are no contract holders to get 50 per cent of any appreciation profits, but they would also get the entire fund and have any profit made by the [fols. 78-81] difference between cash surrender and reserve? Isn't that true?

A. That sounds right to me, but again there is an adjusting factor that makes me qualify my answer because, you see, just to the extent that people come in with their bonds for cash surrender, and from theoretical—at least, the position of Fidel with respect to the surpluses in the collateral trust fund, Fidel is losing the benefit of the periodic monthly income from those same persons. That is why I find it hard to answer you, you see, categorically, yes or no. There are too many ifs and ands here, and I can only say I don't know.

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[fol. 82] Q. Now, by wiping out this liability, or the guaranty of Fidelity to Fidel, the bondholders of Fidel would gain nothing by letting that be wiped out, would they? They

have something now, regardless of whether it is worth a little or worth nothing. They wouldn't gain anything by having it wiped out?

A. Completely discharged, you mean?

Q. Yes.

A. Without any quid pro quo at all?

[fol. 83] Q. Yes.

A. When I said that I really had in mind a wiping out by bankruptcy discharge after the failure of any attempted reorganization. I didn't mean a wiping out with their consent. When I spoke of a readjustment downward to a more or less nominal figure, I did have in mind the readjustment of a reorganization, either in this Court or a state court, which would require, in some manner, shape or form, the consent of the requisite number.

Q. So Fidelity, if it got \$125,000 cash now, has the almost certain potential liability in the future of its guaranty to Fidel, because, as you have told us, Fidel is a wasting asset, and in the future will be a liability to someone, so if the guaranty remains Fidelity contract holders, although they get \$125,000 for the general kitty, are going to have that potential liability in the future? Isn't that right?

A. Unless it is properly cared for in a plan of reorganization—oh, definitely.

Q. I notice you said when these bondholders of Fidel have taken their contracts and paid upon them, that there is an executed contract with Fidelity which puts this guaranty [fols. 84-90] into effect.

The Court: That is a legal conclusion, Mr. Palmer, which this witness, although he is a lawyer, is not qualified to answer in this proceeding.

Mr. Palmer: He has been giving, your Honor, as I understand him, legal conclusions.

The Court: There has been no objection up to now, but I cannot permit such a clear legal conclusion as that. That is a matter for the Court to determine.

[fol. 91] The Witness: During the recess certain figures have been shown me by Mr. Palmer, and I have examined [fol. 92] them, and I have been asked to state these figures for the record and to make any comment in relation to the figures that is relevant to the opinion that I have expressed

that it is to the best interests of Fidelity that the offer be accepted.

The statement was captioned, "Adjustments to bring book surplus of market surplus over net cash liability," the date being as of June 30, 1941.

Now, what follows is with respect to Series A bonds. It appears from this statement, which in turn appears to be correct as per the published financial statements of Fidelity as of June 30, that the surplus per the books, based on book value of investments and actuarial reserve, is, for the unmatured bonds, \$110,293.57, and for the matured bonds, \$519.46, the total being \$110,813.03; and the deficit represented by a comparison of market to book values of investments is shown as follows: in the unmatured fund the book value is \$973,509.94 and the market value is \$915,526.63, the indicated difference between book value and market value being \$57,983.31, which is a deficit in the sense that market value is below book value by the amount indicated.

[fol. 93] With respect to the matured fund the book value is \$6893.60 and the market value is \$7315, so that with respect to the matured fund the market value exceeds book value by \$421.40.

From the same source this statement indicates that the excess of the actuarial reserve over the net cash liability is made up as follows: actuarial reserve is \$981,436.52, net cash liability is \$954,098.03, the excess of actuarial reserve over net cash liability being, therefore, \$27,338.49, and the market surplus over net cash liability is \$80,589.61. Now, so much for Series A.

And referring again to the statement supplied by Mr. Palmer, now with respect to Series B bonds, the surplus per the books based on book value of investments and actuarial reserve is, for the unmatured bonds, \$20,683.14, and for the matured bonds, \$2163.15, the total being \$22,846.29. With respect to the market value over book value of investments, the detail is as follows: in the unmatured fund the book value is \$1,248,207 and the market value is \$1,254,820, the excess of market value over book value being \$6613. In the matured fund, the book value is \$60,996.50 [fol. 94] and the market value is \$50,537.50, the market value being less than the book value by \$10,459, which is indicated here as a deficit in the sense just explained.

The excess of the actuarial reserve over the net cash liability with respect to the Series B bonds is stated as

follows: actuarial reserve, \$1,598,822.01; net cash liability, \$1,548,703.59, the excess of the actuarial reserve over the net cash liability being \$50,118.42; and with respect to these series B bonds the market surplus over net cash liability is \$69,118.71.

Now combining the market surplus over net cash liability of the Series A and Series B funds, there is an aggregate market surplus over net cash liability as of June 30, 1941, of \$149,708.32.

Now from my knowledge of the indenture and the figures—the correctness of which, incidentally, seems to be beyond dispute on the part of anyone, because they are taken from the published statement of Fidel—what I have read, after discussion with Mr. Palmer in the recess, amounts to this:

If every bondholder of Fidel should cash-surrender his bond under circumstances that would not entitle the sur-[fol. 95] rendering bondholder to actual participation in the surplus accumulated in the several collateral trust funds, and all other things remaining equal, there would be \$149,708.32 of market surplus over net cash liability, which should be added to the stated net worth of Fidel Association as per the balance sheet of its own general fund, meaning the fund of free assets not subject to the collateral trust indentures.

Mr. Palmer:

Q. Mr. Kelley, could I interrupt you a minute?

A. Surely.

Q. Then, under these circumstances, the particular offer should be approximately \$125,000 as to surpluses of the general fund, plus \$150,000, as you have given it, or a total of \$275,000? Am I correct?

The Court: Let's wait, before that question is answered, till the witness qualifies what he has said. I think I can see several qualifications, and probably the witness knows a good many more than I do.

The Witness: Actually, your Honor, I think Mr. Palmer's question may have been designed to bring out a couple of [fol. 96] those qualifications, so that there may be no distortion of the picture one way or the other. The first qualification that I have to offer with respect to the picture made by the figures just read into the record is this, that

just to the extent that bondholders of Fidel come in and surrender their bonds, the income which Fidel would expect, and might reasonably expect, to receive from those bondholders by reason of the continuance of their subscription payments in the future would become non-existent; so it would seem to me that that figure of \$149,708.32 must be offset by some indeterminate amount which, if it could be determined, would be the present value of the prospective income that Fidel might normally expect to receive from the contributions made by its bondholders. By contributions of course I mean the installment payments under their subscriptions to their bonds.

In addition I think this qualification must be adverted to, that there is no way that I know of under this indenture in which bondholders could be required, under any circumstances, by any permissible action on the part of Fidel, to come in and accept their cash surrenders, so that the existence of this figure of \$149,708.32 as an actually realizable addition to the net worth of Fidel is wholly contingent upon an accidental circumstance that within a measurable period of time in the foreseeable future every bondholder will come in and cash-surrender his bond, all other things reflected by the statements as of June 30, 1941, remaining substantially equal.

The Court:

Q. As I understood your answer, these values that go to make up the hundred and forty-nine thousand odd figure also include the difference between book values and market values of securities, don't they?

A. Yes, sir, those conditions are all reflected in that ultimate figure of \$149,000 plus.

Q. So that, on a present day basis, if the securities were liquidated there would be no actual value in that difference that you have set up there which goes into the \$149,000, insofar as the difference between the book value and the market value of securities was concerned?

A. Your Honor, that has already been taken into account in this way, you see, that in arriving at the two sub-totals that go into \$149,708.32, the deficit of market value in relation to book value has already been deducted, so you see that full effect has been given to that; so it is [fol. 98] true to say that if, within a measureable period

of time in the future, everything else remaining substantially the same as it is per the statements of June 30, 1941, all Fidel bondholders came in and voluntarily cash-surrendered their contracts, \$149,708.32 would be added to the net worth of Fidel; but as against that all of Fidel's income, its good will as a going concern, and all of the incidents to that status would vanish.

Q. Yes. Go ahead.

A. So that I shan't appear to be in the position of unduly favoring my own opinion that this offer should be accepted, I think I should add that if there is any chance of anyone paying anything for the stock of Fidel in addition to its net worth on the contingency that some—not that some but that all the bondholders will come in and do this, then if such an offer were before the Court I most certainly would recommend that it be accepted and that the Pell, Ltd. offer be rejected.

Mr. Palmer:

Q. Mr. Kelley, do you know that within the last six months, I believe it was testified to here, \$600,000 of face amount certificates had been cash-surrendered?

[fol. 99] A. I didn't know the exact amount, but I did know that from time to time between the date of the institution of the state court proceeding in West Virginia which resulted in the appointment of the receivers and the present time there had been, on specific occasions, exceptionally large cash-surrender demands, but the amount, \$600,000 or some other figure, I could not say.

Q. And if that present rate continued it would only take two or three years until this very contingency that we have been speaking of would happen and all of the policies would be cash-surrendered? Isn't that true?

A. If that rate continued?

Q. Yes.

A. Oh, yes.

Q. Would it be your thought, Mr. Kelley, that before the Court should accept this offer it should see if there are any other persons who might be interested, because of this figure of \$150,000 approximately extra that might be made by anyone if this cash-surrender process continued?

The Court: Well, I can say, without the necessity of the witness answer- that question, that the Court would certainly do that. The Court would require the Trustee, before [fols. 100-116] accepting this offer, to ascertain by all possible means whether there could be any better offer secured from any source.

Mr. Palmer: I presumed that the Court would, naturally. That is all, Mr. Kelley. Thank you.

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[fol. 117] A. G. Swiger—Cross.

Mr. Farmer: That would be true if I could tell if those companies were investment companies.

The Court: This witness has said he doesn't know anything about it except what is on the sheet. Now you ask what is on the sheet. It is already in evidence. Let's get through with this. Objection is sustained to that question.

Mr. Farmer:

Q. Do you mean, Mr. Swiger, that you don't know which of those companies are investment companies?

A. No, I do not, and for this reason, Mr. Farmer. I presumed when I came to Charleston and when this offer was submitted that the Court and counsel would want to know who these parties are and something about their responsibility. I requested each of the directors of Pell, Ltd. to give me a list of their companies which they served as director and executive and so forth, and this, referring to Mr. Stewart's, is Mr. Stewart's own list, which he gave to me and which I have copied into this memorandum.

Q. Now, as to Mr. Pell, you don't know what companies [fols. 118-119] he has listed there are investment companies?

A. No, I wouldn't know.

Q. You didn't bring with you a balance sheet or financial statement of Pell, Ltd., did you?

A. No, I did not.

Q. Sir?

A. But I want to reiterate that Pell, Ltd. doesn't have sufficient money in its treasury today to buy and pay for the Fidel stock, but in the same way, with as much emphasis, if this offer is approved by the Court, Pell, Ltd. will keep its commitments.

Q. And it has not been decided which of these gentlemen would contribute towards the fund necessary to consummate this purchase or in what proportions?

The Court: It doesn't make any difference, Mr. Farmer.

[fol. 120] Mr. Palmer: There was some controversy, your Honor, as to the question of fees—the size of his fees—your Honor, and this witness being intimately acquainted with him for twenty years and being a member of the bar of New York and knowing financial men, would have a very definite idea as to Mr. Koontz's worth to Fidelity and what he did with reference to it in a definite way in New York.

The Court: If he knows anything with reference to the immediate services for which the fees were charged, I will permit him to answer the question; otherwise I will sustain the objection.

Mr. Hillis Townsend: Your Honor, this question and answer are to become a part of the main record? Is that right?

[fols. 121-122] Mr. Palmer: Yes.

Mr. Hillis Townsend: It is not a part of the record on the Trustee's petition?

Mr. Palmer: No, not at all.

The Court:

Q. Do you know anything about these particular services that Mr. Koontz rendered to Fidelity?

A. Your Honor, I wouldn't know unless I would see his bills and see what services he had charged for. I do know this; in fairness to Mr. Koontz, I should say, that I saw him frequently in New York over a period of years. He was in my office many times. He conferred in my office with various people with reference to the affairs of the Fidelity Investment Association. He seemed active in that connection. From my opinion as a lawyer, I would say he did a very good job.

[fol. 1-62] Mr. Palmer: Here is the one I have, your Honor, which was made December 27th 1941, giving notice for Monday January 5th 1942 at ten A. M. "or as soon

thereafter as counsel can be heard," and the motions were brought up on the 5th and later set for hearing today.

That motion is this: "Comes L. H. Brooks, trustee, Frederic Leake and A. L. Goldberg, Jr., trustee and move the Court to order the Central Trust Company, trustee, forthwith to make and file a report in pursuance of Section 167 of the Bankruptcy Act as amended as to the desirability of the formulation of a plan of liquidation in accordance with the suggestion or suggestions copy of which is attached hereto and made a part hereof."

Then they have the plan of liquidation.

Then I have another motion here.

"Come L. H. Brooks, Trustee, Frederic Leake and A. L. Goldberg, Jr., Trustee, and move the Court to order the Central Trust Company, Trustee, forthwith to make and file a report in pursuance to Section 167 of the Bankruptcy Act as amended as to the desirability of the continuance of the Debtor's business, said report to be filed before the Court's decision on the issues now under advisement is [fol. 63] announced and order thereon rendered."

That was accompanied by a memorandum of authorities.

Then I have another motion here by the same persons moving the Court for an order restraining the Central Trust Company from sending out any notices to the policy holders until there has been a division of the creditors into classes, and further that no order be made with regard to filing the claims until there has been a hearing on the motion heretofore filed requiring the trustee to file a report in accordance with Section 167 and 169 of the Bankruptcy Act.

The Court: Before we take up those motions, let me reiterate what I said a few minutes ago, if it was not entirely plain, and that is that I don't propose that the administrative procedure in this case be carried on as a result of motions made by contract holders unless it has first appeared to me that the trustee is in some way lacking in the discharge of its duties; and so before we take up any of these motions I want the trustee to explain what procedure he has in mind, so that I will know whether or not these motions are in order.

Mr. Hillis Townsend: Your Honor, we are very glad to [fol. 64] have that opportunity, and had intended to speak at the proper time.

If the Court please, counsel for the state court receivers and Mr. Farmer have made motions which require more specifically than anything else that the trustee file a report expressing its opinion as to the desirability of the continuation of the debtor's business. The trustee does not believe that this act contemplates a report which contains an opinion on that point without submitting along with it the facts found by the trustee which would justify that opinion. There are several ways in which the administration of this estate might be proceeded with, and the trustee has had to consider a number of different things in formulating, in its mind, the proper plan to follow. Section 167 (1) provides that the trustee shall make certain investigations and report on them to the Court including an expression of the desirability of continuing the debtor's business.

The Court: The report is to the judge.

Mr. Hillis Townsend: To the judge. Section 167 (5) requires that the trustee make a similar investigation and send notice thereof to the contract holders in the form and [fol. 65] manner prescribed by the Court. I might clear-up one of Mr. Farmer's motions and Mr. Lauritzen's objection here right away by saying that at the present time the trustee does not plan to ask the creditors to send in proofs of their claims, and before that is done these parties will be notified and have ample opportunity to present their objections to the Court, but they can dismiss that for the time being, because the trustee does not plan to do that immediately.

The Court: Just what is the plan of the trustee with reference to having the Court pass on these claims?

Mr. Hillis Townsend: This is it. I will be to that in just a moment.

The Court: All right.

Mr. Hillis Townsend: In order to file the report required by Section 167, or for that report the trustee has a great deal of the information required by it. Briefly, this is what the trustee plans to do. It would like to file, and it agrees with counsel who have raised this question that perhaps the time has now come when certain of this information should be filed with the Court and certain of this information should be sent out to the contract holders; but [fol. 66] we are trying to bear in mind that mailing notices to contract holders is expensive in this case, and as many

of them are to be avoided as possible, and the trustee is in position, or will be within a very short time—and we would like for the Court to suggest a date, or perhaps we can agree on a date here—in which it can file a portion of the 167 report which will contain an expression as to the desirability of continuing the debtor's business and a great many other of the facts that are required by those sections.

Of course your Honor doubtless knows that the cloud that hangs over the administration of this trust is the appeal that is pending in the Circuit Court of Appeals. Some of this procedure is going to be expensive, regardless of exactly what form is adopted and regardless of when it is done. The trustee has been very mindful of the fact that if a lot of money is spent in an expensive procedure for the classification of claims and the determining of the rights of creditors, and then the jurisdiction of this Court is vacated by a decision of the Circuit Court of Appeals, that money is gone and no good will have been done; and we disagree with counsel that that would be information [fol. 67] which might be used by any other Court that took jurisdiction of this case. So the trustee, therefore, has not believed it advisable to enter into this claim procedure before or at the time of filing and submitting the greater part of the 167 report. It would like to do that first and can do that and will do it within any short time of a few weeks which might be settled on here today, and as I say that report will contain the trustee's opinion about the desirability of continuing the business; and if these gentlemen want to use that, and think they can get it into the record properly before the appellate court and want to use it, the trustee will certainly have no objection to it going into the record.

After this information is before the Court which is required by Section 167, it then becomes the duty of the trustee to send this information to the creditors, and they, as I understand the law, in the light of this information, are entitled to submit a plan. Obviously a plan can't be submitted until this 167 report is in and this information is sent to the creditors and they have had their opportunity to submit proposals for a plan. Therefore no plan can be [fol. 68] submitted by the trustee until that has been done, and we think that the classification of the creditors can more properly be decided by the Court in connection with the

Court's approval of the plan, because if it is done that way it might obviate one more appeal in this case. We think that there will doubtless be an appeal from the decision of the Court on the question of the classification of creditors, and we think also there probably will be an appeal on the question of the adoption of a plan or approval of a plan by the Court. Now, if the trustee can proceed in such a manner as to get this question decided at the same time and in the same proceeding before this Court, then those appeals can be combined and decided at one time and whatever proceeding is ultimately adopted could go ahead from that point.

That, briefly, states the plan which the trustee has in mind, and we are willing to have the Court fix any time within say four to six weeks or so within which the most of this—two months would perhaps be better—for the balance of this 167 report, except as to the recommendations as to the formulation of a plan.

We can't help but have some feeling over the fact that [fol. 69] counsel have repeatedly stated here in court that the trustee has been ordered to do something which it has failed to do. We don't think that any orders have been entered directing the trustee to file this report or any part of it. Your Honor has expressed your opinion as to when those things should be done on two or three occasions; and I think it is proper to say that those expressions were made at a point in this proceeding where none of us knew the course that it would take.

Another thing which comes to our minds in this connection is this. This criticism comes from the state court receivers, who have filed an appeal from your Honor's decision taking jurisdiction of this case. They are the ones, and the only ones, that have voiced any criticism of the course that has been pursued by the trustee. None of the creditors have complained that I know about, and some of the creditors have promptly expressed their approval of the method. If any expensive procedure is engaged in by the trustee at this point, as they seem to think it should be, and they prevail in their appeal, then that will negate anything that is done at this time; and we can't quite appreciate [fol. 70] the position that they take in insisting that the trustee do something which they, by prosecuting the appeal, would undo if they prevail on their appeal. That, in brief, is our position at this time.

Mr. Warner: May I say a word, your Honor?

The Court: Yes, Mr. Warner.

Mr. Warner: On behalf of the creditors whom I represent, I think that the trustee should do nothing except routine work and administrative work. He would be subject to criticism by contractholders if he incurred extraordinary expense here for nothing. I am advised it will cost around \$25,000 to have an audit made. It will certainly take a lot of time. It will take a lot of time of attorneys and plenty of expense to classify the creditors and formulate a plan; and it all may result in nothing at all if the Circuit Court of Appeals vacates the order of this Court. I think the trustee would be subject to criticism if it incurred any unnecessary expense without a specific order of this Court.

Mr. Eney: I have listened, your Honor, with a great deal of interest to what Mr. Townsend had to say. As I understand him, what he suggests is that the trustee will, except [fol. 71] for purely administrative matters, stay the proceedings pending the appeal. If that is the considered opinion of the trustee I won't quarrel with it, although I had rather anticipated that the Court, having decided the question of jurisdiction, would go ahead. There are two things, however, which occur to me as being questions which necessarily must be determined by the Court before any effective work can be done for developing a plan of reorganization or determining that any such plan can be developed. Those questions are a number, but they can be divided into two classes. First, the method or the manner in which claims of contract holders shall be computed. I don't feel that the trustee can possibly make any plan or formulate a plan, nor do I believe any creditor or creditors' committee could formulate a plan, without having some basis for the classifying of the claims. We have talked glibly of cash surrender values of the contracts. I, for one, think that is not a proper method of classifying the claims. I don't think cash surrender value is proper, because it cuts out a large number of creditors who had no cash surrender values, but who are in no wise in default.

[fol. 72] The Court: Who are they?

Mr. Eney: The people that paid less than eleven months.

The Court: They would have equity in the case of reorganization on the basis of a face amount certificate com-

pany, but would have no equity in case of liquidation, either sudden or slow and orderly. Is that right?

Mr. Eney: I don't think so. That is the view that has been talked about in the proceeding, but I don't personally believe it is right at all. I may be wrong, but it seems to me that that group of persons, people who have not broken their contracts, I don't believe it is equitable for the Court to say to them, "You are just out; you have no claim, because you have been contract holders and paid in for ten months, whereas someone else has paid in for twenty months." But whether I am right or somebody else is right, the Courts can determine whether it is on the basis of cash surrender values, on the basis of reserve values, on the basis of amounts paid in, either discounted or improved at the lawful rate or just flat amounts paid in, or what personally I think is an entirely different theory and [fol. 73] a proper one, which I have discussed with counsel for the trustee. I won't stop to go into it, but I think the Court must at some time in this proceeding determine, not for each particular contract holder, but all contract holders that their claims shall be computed in accordance with a certain formula, a uniform formula.

The Court: Do you believe that an order determining those things would be an appealable order?

Mr. Eney: I don't think an order determining that alone would necessarily be an appealable order, no, sir. I think that in connection with the other question I am about to mention it might be, and that is this. The act provides, and necessarily so, that the Court shall determine what creditors are secured and what are unsecured, and what creditors; who, while not secured, have priorities, as for instance, the United States Government tax claims and perhaps, others; and in addition to that the Court is required to fix a time for hearing and for determining whether or not certain creditors are or are not secured, and to value the amount of their security and determine the extent to which it is secured and the extent to which it is unsecured. In this particular proceeding, in view of the contentions made, that [fol. 74] seems to me to mean that the Court must say with respect to Maryland, for instance, "I am going to fix a day for a hearing to determine whether the Maryland law makes contract holders in Maryland secured creditors, and if I determine that the Maryland law does make them secured creditors to the extent of the deposit there, then I am going

to value that deposit and determine the liabilities in Maryland and to say that creditor is to a certain extent secured and to a certain extent unsecured."

In doing that, in order to determine the liability side of that question, the Court would have, either at that time or prior thereto, to have fixed the manner in which the claims shall be calculated. That involves not necessarily a series of hearings; it can be done in one hearing; but it would involve a separate consideration as to each state. Your Honor might very well say that Wisconsin contract holders are secured and Maryland contract holders are not. In addition to that you have got the question of who are the Maryland contract holders who are secured by the Maryland statutes, if you determine that some are; are they the contracts that were sold in Maryland? Are they holders [fols. 75-81] of contracts who now reside in Maryland, or just who are they? I think those questions must be determined before the trustee can act, because in formulating a plan the trustee, under the case of Case v. Los Angeles and others, no plan can give a contract holder less than his legal right, so necessarily the Court must say what the legal right of the contract holder is, x dollars, in order to guide the trustee as to the minimum that can be allowed that particular one individual in any plan of reorganization. Even though it is approved by every contract holder but one, that one contract holder could upset the plan if his contract is cut below its legal minimum.

What I had in mind is this. I understand that the trustee is about to mail out communications to contract holders at the present time. I don't know how much it costs to mail notices, but it certainly must cost twelve or fifteen hundred dollars in postage alone, plus other expenses.

[fol. 82] Mr. Eney: One other thing I wanted to say, and that is I don't see how the trustee can make a report which would indicate the specific participation of each creditor or class of creditors in any reorganization, but the trustee has indicated its opinion, and it seems to me reasonable that the trustee could file a report indicating the possible framework of a plan, leaving to the determination of this Court on a hearing the specific participation that each creditor would have in that plan.

[fol. 83] Mr. Palmer: I think there is a difference of language. [fol. 84] What I meant was the listing of creditors into classes, for instance, series classes or state depository classes. However, that is not so important as the 167 report. At that time there was a discussion as to the 167 report being filed in its entirety, and Mr. Townsend said there was no order entered on it, but the Court, in the record, stated.

"I did not remember an order had been entered requiring the filing of a report under Section 167 today, but by September 5th."

But the Court, in that same hearing on August 5th, went on to state,

"I am going to extend the time now for filing the 167 report to October 5th, and the time for the suggestions to be filed with the trustee on the plan to November 5th."

On October 5th there was a further discussion, and Mr. Farmer made an objection to extending the time. The Court, however, extended the time for filing the 167 plan to November 5th.

At the discussion on August 5th the trustee said they wanted six months. Mr. Reinhardt, Mr. Lauritzen and the Court said at that time, which was true and is still true, [fol. 85] that if this company was ever to be reorganized that time was of the essence, and the Court for that reason indicated that if there was to be a reorganization the trustee would, of necessity, have to get his 167 report in promptly, to be followed within one month by suggestions from the contract holders as to the formulation of a plan.

November 5th came and went by and December 5th came and went by, and the trustee was inquired of by me personally as to the filing of the 167 report. That 167 report is of vital importance in this appeal. If it shows that the debtor should not now continue its business, which I think is undisputed by anyone that it should not now continue its face amount securities business, although the court order of June 5th says it shall continue that business and that order has never been changed; the trustee is authorized to continue the debtor in business and there has never been any change in that order.

The Court: Continue the debtor how?

Mr. Palmer: It just says to continue in business.

The Court: I would like to see that. I don't know what you refer to.

Mr. Palmer: I think I have the exact order here.

[fol. 86] The Court: I am sure there wasn't any order of this Court that the debtor continue to go ahead and sell contracts, if that is what you mean.

Mr. Palmer: In the second page of the order approving the debtor's petition, entered on June 6th, it was ordered that the trustee give bond, and so forth, and "subject to the authorization and control of this Court, shall carry on, manage, conduct and operate the business of the debtor in its usual course."

The Court: Well, we have never done that, and we have never had any idea that it was to be done, and if there was any question about that and it had been called to the Court's attention the Court would have long ago clarified it; but that didn't and doesn't mean that the business of this concern is to be carried on; they never have carried on any business under this Court except that there have been some payments received and segregated and many of them returned to the persons who sent them in.

Mr. Palmer: I think your Honor, the trustee and ourselves are in full accord on that. However, Mr. Farmer's point is this: that order was entered, and he has repeatedly asked that the trustee file a report stating that it is not [fol. 87] now desirable that its business be continued, which will then wipe out that order, and the trustee has consistently refused to do that.

The Court: That is a peculiar way to get at it. If that had been called to the Court's attention at the first hearing, the Court would have gladly clarified that by saying that it is not to be continued.

Mr. Palmer: I don't know why Mr. Farmer didn't call your attention to it.

The Court: There is no need for the trustee to file a report on that. I will just say, and enter an order, if you want it, that that did not mean and does not now mean that there is to be any business of an original nature carried on by this trustee on behalf of the debtor.

Mr. Palmer: That will dispose of one of Mr. Farmer's motions.

Now, Your Honor, with reference further to the 167 report, it is and has been highly desirable that that report come in as to the questions, and particularly the 169—well, that part may be what the Court says includes this,

in 167(5), a report on the properties, liabilities, and financial conditions of the debtor, the operation of its business, [fol. 88] and the desirability of the continuance thereof. I presume what the Court has said will answer that request of Mr. Farmer as to the report to be made by the trustee as to the desirability of the continuance of the business.

The Court: I am frank to say that I don't understand that motion in the way it is being presented. If I have a misunderstanding of it I would like to be told now. Certainly you, Mr. Palmer, and Mr. Farmer as well, know as well as any of us know that the business of this company has never been carried on.

Mr. Palmer: Yes, sir.

The Court: And that, therefore, the only possible occasion for any such motion as is being made now is the fact that you found some language in the original order which you believe authorizes the business to be carried on, and you now, for the first time, point to that and say, "I want to make a motion for the trustee to come in with a report and say whether that is desirable or necessary." Now, I just don't understand that sort of procedure. The reason I say that is because, here is a matter that was open to all of us for more than six months, and certainly could [fol. 89] have been taken care of in some other way than this.

Mr. Palmer: I think here is the trouble, your Honor, that 167, and the entire Chapter Ten, does not specifically contemplate such an unusual type of company as Fidelity; that the ordinary report under 167(5) is for, say a concern making cotton stockings, and the trustee is to report immediately to the Court whether the company ought to go on and continue to make cotton stockings, or close up, and that report is desired. Because of the peculiar kind of company Fidelity is this language is hard to apply to the specific case. We all know, as the Court has said, that from the 1st of January 1941 no one attempted to sell any Fidelity contract, and the trustee, in taking over, and the Court, in authorizing it, did not contemplate that; but I think what Mr. Farmer has in mind—and I am speaking for him in this motion—is that he wants the trustee to go on record as saying that the business that Fidelity was doing is not a business such as the trustee would advise the Court

ought to be continued in during the course of the trusteeship.

The Court: The Court is not going to require the trustees [fol. 90] to do that, so that motion is overruled now.

Mr. Palmer: All right, sir; that is one of the things Mr. Farmer wanted a decision on.

Mr. Reinhardt: May I interrupt a minute?

Mr. Palmer: Surely.

Mr. Reinhardt: This may be quibbling, but I don't like to let any possibility of misunderstanding go by. This business of Fidelity's is not so peculiar that it is hard to apply Section 167 to it. There have been other companies very similar to Fidelity that have operated under Chapter Ten and within the framework of 167. The part of 167 that requires the trustee to report on the operation of the debtor's business and the desirability of a continuance thereof, looks to the formulation of a plan of reorganization, as is evidenced by the following language, "And any other matter relevant to the procedure or to the formulation of a plan." Now, the kind of report that that contemplates is a report to the Court saying, "Judge, the business of the debtor should or should not be continued during the pendency of the proceeding, and should or should not be continued after the proceeding when the company is reorganized." The whole thing is the basis [fol. 91] on which the structure of the plan is erected, and for that purpose it seems to me that a report by the trustee as to the desirability of a continuation of the debtor's business is something that is called for under the statute.

The Court: I didn't mean to say that it wasn't. I say that I am not going, by special order, to direct this trustee to do anything about that.

Mr. Reinhardt: I wasn't addressing myself to your Honor's remarks, but rather to Mr. Palmer's, so as to avoid any possibility of confusion as to what the statute calls for. I do think the statute calls for that kind of report on the part of the trustee as part of a report as to what kind of plan, if any, might be feasible.

Mr. Palmer: I am glad of Mr. Reinhardt's explanation. I think it is well taken, and I know that that is what Mr. Farmer wanted the Court to order the trustee to do, which the Court has declined to so order.

The next report he wants is the Court to require the trustee to report under Section 169, which provides that "the

trustee shall prepare and file a plan or report of its reasons why a plan cannot be effected, and shall fix a subsequent time for a hearing on such plan or report; and for the consideration of any objections which may be made."

In behalf of that motion and the other part of Mr. Farmer's motions, your Honor, the Court, perhaps not by order, but by dictation into the record, did fix a time in which the desirability of continuing Fidelity should be determined, that is, as a going concern. The Court has indicated that there can be a reorganization without necessarily having Fidelity as a going concern. The trustee, Mr. Farmer feels, should give the Court and contract holders and interested parties under the requirements of Chapter Ten its ideas as to whether Fidelity should be again operated as a going concern or whether it should not be; and Mr. Farmer would like the Court to require, as the Court has already done in the record a number of times, that the trustee do what the Court ordered it to do, file a report.

The Court: Well, the remarks of Mr. Townsend, as attorney for the trustee, have indicated the reasons why the trustee has not gone ahead with that, the chief one being the fact that the state court receivers have been consistently fighting against the administration of the company's affairs in this court; and I am persuaded by his remarks that the [fol. 93] trustee had good reason for not going ahead any faster than he has, and if the record is in such form that it shows any delinquency on the part of the trustee in failing to file this report, the Court will now extend the time and make it the sixty days from now that Mr. Townsend has said it will take.

[fol. 94] Mr. T. C. Townsend: Your Honor, I would like to say a word, if Mr. Palmer is through.

[fol. 95] The Court: All right.

Mr. T. C. Townsend: I understood Mr. Palmer to say that the trustee, in all probability, had purposely delayed the proceedings in connection with the filing of the 167 report. This case has already been in the Circuit Court of Appeals on two different phases of it, both times taken there by Mr. Palmer, both times against the trustee. It is there now on the third appeal, and Mr. Palmer has changed his defendant now and proceeds against the debtor and

leaves the trustee clear out of it. I want to say a word or two. We are representing the trustee and we are defending the trustee the best we can. From the beginning of the responsibility cast upon the trustee by the petition filed in this case he has done the best he could to comply with the provisions of Chapter Ten and to function under Chapter Ten, under great difficulties and, may I say, harassment on every hand.

Now, just to demonstrate to your Honor the situation that is here today. Mr. Lauritzen, representing his clients, doesn't want any notice sent out at all to the contract holders. I believe I understand him correctly.

Mr. Lauritzen: No, the notice I was speaking of, Mr. [fol. 96] Townsend, was a notice telling them to file their claims.

Mr. Townsend: All right, he doesn't want a notice sent out asking the contract holders to file their claims; it might embarrass the situation up in Wisconsin if it did that, his relationship to his client or the contract holders. Mr. Eney wants a classification of the creditors forthwith, and so does Farmer—or I will modify the term, "forthwith" by saying at as early a day as he can get it he thinks that is the thing to do. Mr. Warner says that if anything is done in this case until the jurisdiction of the Court is settled, the contract holders will suffer. Just exactly what Mr. Palmer wants I must confess that I don't know now and for a long time I have not known.

Mr. Palmer: I will be glad to advise you, Mr. Townsend.

Mr. T. C. Townsend: Well, you have tried that for several months, and, it may be my stupidity, but I am not advised yet.

What the trustee has done is this, your Honor. The trustee complied literally with the report required under 164, and went further than that section provided in furnishing [fol. 97] information. Some of the information asked by motion filed here today is already in the 164 report. Some confusion did arise with reference to 167, but it is not necessary to go into that. It is only necessary to say that the trustee did file a partial report under Section 167, and the trustee is now ready and willing to proceed with all reasonable dispatch to file a further report under Section 167 within the time fixed by the Court.

Now, that is all the trustee can do. If there has been any delay in this matter, if it has been postponed beyond the

time when these gentlemen think these reports ought to be filed, it is not the fault of the trustee. The position taken here today seems to me simply anomalous and remarkable and not understandable to me. There is an appeal pending in the Circuit Court of Appeals, prosecuted by the state court receivers and others. If that appeal is decided adversely to what this Court decided, all these questions we have been talking about here today are settled, and definitely settled. In other words, they are taking the position that this Court has no jurisdiction to do anything, the trustee has no jurisdiction to do anything, never has had [fols. 98-113] and doesn't have now, and "we are going to win this appeal and they won't have in the future"—that is the position they take. On the other hand they do this, they are asking this trustee to proceed to make reports and file them in this Court under a proceedings which these gentlemen say—some of them, at least; I don't say it is all of them—that this Court has no jurisdiction over at all.

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Endorsed on Cover: File No. 46,820. U. S. Circuit Court of Appeals, Fourth Circuit. Term No. 319. Fidelity Assurance Association, a corporation, Debtor, and Central Trust Company, Trustee for Fidelity Assurance Association, Petitioners, vs. Edgar B. Sims, Auditor of the State of West Virginia, and Ex-Officio Insurance Commissioner of the State of West Virginia, et al. Petition for a writ of certiorari and exhibit thereto. Filed August 20, 1942. Term No. 319 O. T. 1942.

